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The Implementation of Control Mechanisms in European Multinationals: A Comparison of British and German Subsidiaries in Venezuela

By

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DECLARATION

None of the materials contained in this thesis has been submitted for publication prior to the start of the candidature for the Doctoral Degree. However, some of the work in the thesis has been published or submitted for the publication in refereed international conferences prior to the completion of the thesis.

SUMMARY

In organizational theory, there is increased concern over how a particular context affects the operations of firms, especially in multinational organizations. As these firms operate in different contexts, there is growing interest in learning how social institutions from these contexts may influence the operations of these firms. MNC subsidiaries, principally, have attracted the attention of academics because they move in different spaces that are interrelated (e.g., country of origin, industry and country of operations), which may have different institutional settings. The implementation of control mechanisms in MNC subsidiaries represents an organizational area that is significantly influenced by these forces.

This thesis develops a theoretical framework to explain the presence of control devices in MNC subsidiaries. The framework encompasses different levels of analysis: country of origin, country of operations, industry and the organization itself. The aim is to explain the presence of control mechanisms in MNC subsidiaries by examining features that might affect the implementation of these devices. The framework places particular emphasis on two areas. First, understanding the effect of institutions based in the country of origin on the implementation of control mechanisms in MNCs. And second, appreciating the effect of institutions in the country of operations on the implementation of these devices in subsidiaries.

To examine these issues the research has built on MNC theory and institutionalist theory. The scope of the research is limited to four case studies: two from Britain and two from Germany. The research design is of comparative nature and the comparison is across countries and industries. The industries selected are oilfield services and business software. Venezuela, the country of operations presents a context with dissimilar characteristics when is compared either to Germany or Britain, in light of its fragmented institutional system.

The findings of the research have contributed to share more light into how the country of origin and country of operations impact the management of MNC subsidiaries. The research has shown the dynamic nature of institutional systems, and how this dynamism affects the implementation of control mechanisms. It also has demonstrated the effect of unstable environments on the operations of MNC subsidiaries and on the implementation of control devices.

ABREVIATIONS

ASN: Atrophy through Subsidiary Neglects

*BSs: B*usiness Systems

BV: Baan subsidiary in Venezuela

ECLAC: United Nations Economic Commission for Latin America and the Caribbean

ES: Enterprise Systems

ExBaanVe: Baan distributor

FDI: Foreign Direct Investment

GAAP: Generally Accepted Accounting Principles

HR: Human Resource

HSES: Health, Safety, Environment and Security

IAS: International Accounting Standards

IRHM: International Human Resource Management

IT: Information Technology

MNCs: Multinationals

MRP: Manufacturing Resource Planning

NOC: National Oil Companies

SAC: SAP subsidiary for the Andean and the Caribbean region

SCP: Structure-Conduct-Performance

OPEC: Organisation of the Petroleum Exporting Countries

PDI: Parent-Driven Investment

PDD: Parent-Driven Divestment

PEV: Preussag Energie Venezuela

Rand D: Research and Development

SDE: Subsidiary-Driven charter Extension

SDR: Subsidiary-Driven charter Reinforcement

PDVSA: Petróleos de Venezuela

VET: Vocational Education and Training

UK: United Kingdom

Introduction

In the development of MNC theory, there is a particular interest in the study of how multinationals (MNCs) evolve and in the identification of the forces that intervene in their configuration. The increasing globalisation of the world economy has a common element, which is the MNCs. UNCTAD (UNCTAD 1996) estimates that there are around 39,000 parent-company MNCs controlling 265,000 foreign affiliates. According to its estimates, they also account for around two-thirds of world exports of goods and services. This increasing power of MNCs in the trade of goods and services has attracted the attention of academic scholars who are looking at MNCs as distinctive organisational forms, which are exposed to different environments. The focus of this research is the study of MNC subsidiaries and the implementation of control mechanisms in them. The interest of many scholars has focused on the application of organisational theory to the area of international business by emphasizing the importance of institutional contexts in the development and management of these firms. Following this line of enquiry, one aim of this thesis is to enhance understanding of what factors influence the implementation of control devices in MNC subsidiaries, considering the context in which they are embedded. A second aim is to shed some light on how these factors influence the implementation of these devices in such firms.

This thesis looks at the implementation of these devices in two British and two German MNC subsidiaries in Venezuela. They have operations in two industries: oilfield services and business software. A cross-case comparison of four MNC subsidiaries (SAP subsidiary for the Andean and the Caribbean, exBaan Ve, Preussag Venezuela and Lasmo Venezuela), based on extensive fieldwork, is the empirical ground for the research.

Rationale for the Study

There is an academic interest in the effect of national institutions on the operations of MNCs. Extensive research has been carried out into the effect of social institutions in the shape adopted by local firms. The research has had a major focus on European institutions to explain the differences found in firms from a variety of European origins. However, it has been acknowledged that the internationalisation of firms exposes them to environments with other institutional arrangements, which may differ from the original one. In this context, this study attempts to answer questions concerning the implications for the operations of MNC subsidiaries of operating in a different context. In order to do so, the research focus is the form adopted by control mechanisms in MNC subsidiaries and how contexts (country of origin and country of operations and sector) affect the implementation of these devices.

The study of control mechanisms in MNCs is a subject in which academic researchers have shown substantial interest. However, it has followed an evolutionary process in its study, which has changed the underlying assumptions concerning the nature of the MNC subsidiaries. An initial view of a hierarchical relationship between the corporate offices and the subsidiary has moved to an increasing understanding of the power of the subsidiary to accept or reject impositions from the corporate offices. Different research approaches such as the contingency approach have been developed, which defends the idea that there are particular circumstances of the environment and specific organisation dynamics that explain the selection of control mechanisms. Another research approach has been to consider an evolutionary process in the adoption of control mechanisms in MNCs. The increasing demands of globalisation have created demands on firms to develop more complex devices to manage their operations. Finally, the institutionalist stream of thought defends the idea that the existence of these devices is explained by the origins of the firm. This stream of research has identified some patterns of control mechanisms implemented in the MNC subsidiaries according to the country of origin of the firm.

The institutionalist stream has focused attention on the effect of the country of origin of the MNC in the existence of these devices. However, the effect of the country of operations of the subsidiary is an area with limited research. It can be hypothesized, though, that there is an influence from the country of operations on the operations of MNC subsidiaries. This research attempts to fill this gap by looking at the effects of the country of origin and the country of operations in the implementation of control mechanisms in MNC subsidiaries.

A key argument of this thesis is that the configuration of these devices in the MNC subsidiaries is determined by a set of forces: national influences (parent country and country of operations), sectoral factors, and organisational influences (corporate offices and subsidiary). The thesis develops a framework which considers different perspectives on the analysis of these devices. This framework seen the subsidiary as an entity, which integrates the corporate mandate (which is influenced by the country of origin of the MNC), deals with the opportunities and constraints of the host environment, and is influenced by the industry characteristics, all of this filtered by the strategic choices of its managers. All these forces affect the subsidiary development and the presence of control devices in the subsidiary, too.

These considerations have influenced the selection of the case studies. MNCs from two countries with distinctive institutional arrangements have been chosen: Germany and Britain. This selection supports a comparative analysis of the country of origin effect. The selection of the country of operations, which also have a distinctive nature, is part of this rationale. The effect of institutions, which belong to particularistic contexts such as Venezuela on the operations of MNC subsidiaries, has been subject to limited research. The research on the effect of the country of operations has concentrated largely on market sizes and their volatility and complexity, but it has neglected the effect of institutional arrangements in the operations of subsidiaries. The thesis shows the effect that context with weak institutional environments has on the operations of MNC subsidiaries.

The inclusion of the sector of operations in the framework of analysis implies the selection of MNC subsidiaries that are operating in the same industry, but have different countries of origin. This combination across industries looks to identify those forces that are common and do not respond to country of origin and country of operations effects and can be more contingent.

The Argument and Approach of the Thesis

The thesis has a theoretical basis in institutionalist theory. Shared here is the view that social institutions affect the shape of firms. Different institutional arrangements affect in a distinctive way the operations of firms, leading to distinctive organisational characteristics and firm behaviour. The economic coordinating mechanisms, shaped by the institutional arrangements of the country, place constraints and opportunities in front of the economic actors (Hollingsworth and Boyer R., 1998; Lane 1992;Whitley 1992a). The effect of institutions in the operations of firms, particularly the country of origin effect, has traditionally been studied from a static position. In other words, it has been assumed that institutions do not change, therefore, their effect in organisations is the same over time. This thesis takes a more dynamic perspective of the nature of institutions and concludes that they are subject to change and evolution. This opens the space for more hybrid organisations in which practices from the country of origin coexist with other set of practices that may have other origins.

The exposure of MNC subsidiaries to different environmental forces confronts makes them with contrasting demands. On one hand, pressures to be incorporated with the rest of the organisation and; on the other hand, to localise operations and be integrated with the local context. As a consequence, MNCs are facing, at the same time, pressures to adapt to the conditions in the local environment but also to achieve consistency with the rest of the firm, sharing the patterns of the parent MNC (Quintanilla, 1998; Ferner and Quintanilla, 1998; Rosenzweig and Singh, 1991).

These two opposite demands are reflected in the type of practices which are implemented in the subsidiary. It is argued that MNCs are becoming hybrid organisations, which are neither completely integrated nor fully localised. There is a process of adoption of practices, which do not always respond to the origins of the firm, but which are framed by these origins. This thesis defends the idea that MNCs may take a hybrid form, however, there is still a strong country of origin effect that shapes their operations.

The pressure to localise operations in the country of operations varies according to the characteristics of the local institutional context. Some contexts with strong and complementary institutions create more pressures to adopt host business practices (Whitley, 2005). The firms have strong demands to adapt to the local environment in order to survive. It would be expected, considering this position, that weak institutional contexts would concede more room for MNC subsidiaries to implement their practices. However, the absence of institutions on which the subsidiaries can rely to support their operations, as in Venezuela, forces them to develop practices and capabilities which mainly respond to the local context and have little strategic value for the MNC. Therefore, the hybridisation of the subsidiary occurs, with the adoption of local practices and the adaptation of the practices imported from abroad; however, the transfer of the practices to other sites of the MNC it is very difficult.

The risk of environmental determinism in this research may be avoided by analysing the development of capabilities in the subsidiary. The resource-based approach is the framework that complements the institutionalist stream of thought. It emphasises the importance of the internal resources of the firm. These resources are not only physical assets, but also comprise capabilities, organisational processes, knowledge, and so on (Barney, 1991). Accordingly, a definition of the firm in terms of what it is capable of doing may be more accurate to understand its development of capabilities. According to this, a subsidiary can be studied as an organisational form with some level of autonomy with its own stock of particular resources. However, the combination of the theoretical frameworks of institutionalism and the resource-based view indicates that the selection of resources and the type of capabilities developed in the subsidiary are shaped by the characteristics of the social context in which the subsidiary is embedded. The implementation of control mechanisms in MNC subsidiaries depends in a good measure, on the characteristics of the context in which resource decisions and managerial choices are made.

Overview of the Thesis

This thesis is organised as follows: Chapter 1 presents a literature review on MNC theory, which is the basis for the development of the analytical framework of the thesis. It reviews the main literature on the management of MNC subsidiaries and defines the typology used in this thesis to analyse the control mechanisms in the case studies. Hence, the analytical framework of thesis is presented. Chapter 2 discusses the methodological underpinnings, the research design and the justification for using a qualitative methodology to answer the research questions posed in Chapter 1. Chapter 3 presents the framework for analysing the effects of the country of origin and the country of operations, and discusses the business environments of Germany, Britain, and Venezuela, analysing their effects on the operations of firms from the three countries. It also develops ideal combinations of control mechanisms in MNCs according to the country of origin of the case studies: Germany and Britain. Chapter 4 presents the main characteristics in Venezuela of the two industries of operations of the MNC subsidiaries: business software and oilfield services. The chapter also presents the evolution and major trends of the two industries. In Chapter 5 the cases of the oilfield service industry are presented and the main control mechanisms are highlighted. Chapter 6 follows the same structure to present the business software subsidiaries. Chapter 7 presents a comparison and analysis of the four cases. Finally, Chapter 8 summarises the major research findings, their implications, the limitations of the investigation and some suggestions for future research.

Chapter 1:The MNC Subsidiaries and their Management

1.1 Introduction

This chapter has two main aims. The first is to address the main debates in the literature regarding the nature and management of the MNC subsidiaries and the existence of control mechanisms in MNCs. This review helps to understand the complexity associated with the study of this type of organisation and the implementation of control mechanisms in these units. As a second aim, it presents an analytical framework, which integrates a multilevel of analysis, for studying the presence of control mechanisms in MNC subsidiaries. The framework seeks to incorporate different perspectives, which complement each other, in order to analyse the presence of these devices.

The chapter is structured as follows. Firstly, it presents the main debate concerning the study of the internationalisation of firms. Secondly, the analysis turns to the study of the management of subsidiaries, presenting different research streams which are concentrated in the study of these units. Thirdly, this section illustrates the reasons for the existence of control mechanisms in MNCs. It also presents a review of the different classifications developed to study these devices. A fourth section describes different perspectives that explain the existence of these mechanisms in MNCs. The next section presents an analytical framework for studying the presence of control mechanisms in MNC subsidiaries. Finally, the main points of the chapter are summarized in the Conclusions section.

1.2 The Internationalisation of Business Firms

One of the most influential organizational forms in the world today is the MNC. The emergence of the new information and communication tools derived from the Internet era has increased the number of firms which have activities across borders and maintain multiple units operating in various environments. According to Dicken (1999), MNCs have become the primary shapers of the contemporary global economy. The massive growth of foreign direct investment (FDI) from firms and the increase in the variety of sources and destinations, although there is still a large concentration of the FDI in developed economies, reflect the powerful role that this organisational form is playing in the global economy.

There has been extensive research into the study of international business and multinationals. The studies in this area have been concentrated mostly in two distinctive streams: one which looks for patterns to understand the reasons for internationalisation, and the other which focuses on the study of MNCs as organisational forms. The first approach is grounded in macro-economic theory of international trade and micro-economic theory of the firm. Dunning's (1993) eclectic paradigm illustrates clearly the focus of this stream. It has become a leading conceptual framework to analyse the international expansion of organisations, and builds upon the interactions among ownership-specific factors, internalisation incentive advantages and location-specific variables. This framework incorporates elements from different levels, and assumes variations according to nationality of the firm, sector of operation and intra-organizational characteristics. In addition, it also identifies key location advantages in foreign countries to understand the international production of firms (Rugman and Verbeke, 2001). The main contribution of Dunning (1993) has been to provide a conceptual structure within specific cases can be examined.

Porter's (1990) "diamond" of competitive advantage is another framework developed in accordance with this stream of thought, and has been used extensively by managers and policy-makers to understand the role of the availability of national resources in international competitiveness. It has its basis in the structure-conduct-performance (SCP) approach to industrial organization. This framework analyses the relative efficiencies of producing products in different countries. It presents four inter-related factors at the industry level, which are the key determinants within a nation of its international competitiveness in a specific industry. However, Porter's framework has been criticised in two areas. On one hand, it neglects the systematic advantages created by MNCs from the common governance of a number of value-dispersed activities. On the other, it does not consider the benefits that the MNC accrues through the ownership of assets which have been created on the basis of the competitive advantages of host countries (Rugman and Verbeke, 2001). In other words, this framework does not consider the fact that the internationalisation of a firm supports an organisational learning that is internalised by the firm with the development of organisational capabilities. These give the possibility to MNCs to compete according to capabilities which have been developed during the internationalisation of the firm.

The other stream of research has its focus on the study of MNCs as an organisational form. This stream concentrates its research on the analytical challenges of understanding MNCs as organisations. It has its roots in the strategy-structure paradigm of Alfred Chandler (1962), who stated that organisational structure should follow strategy. There is a set of four stages of corporate development. Firstly, the entrepreneurial stage: initial expansion and accumulation of resources. Second, the rationalisation of resources: the firm develops a functional structure. Third, the expansion stage in which the firm diversify into new products and markets. The fourth stage is the adoption of the multidivisional form, to ensure the efficient exploitation of the diversified resources of the corporation. One of the main assumptions of this approach is the evolutionary nature of the MNC form. The internationalisation process of the MNC is seen as incremental, and the model presumes that there are changes in the organisational structure over time. The studies in this area have identified internal selection forces, such as production diversification and geographical dispersion, as the main drivers of structural change.

Further research in the study of MNCs as organisational form has applied the Integration-Responsiveness framework (Lawrence and Lorsch, 1967). It has incorporated together with the internal selection forces mentioned above, the environment as other factor that influences the MNC evolution. This new framework, in which MNCs features from inside the firms but also from the environment affect operations, incorporated additional aspects as explanations for the selection of specific organisation designs in MNCs.

With the incorporation of external factors into the analysis of the MNC form, an evolutionary approach was developed, producing different models that converged on a distinctive organizational form. For Hedlund (1986) was the "heterarchy" model; for Ghoshal and Bartlett (1998), the "transnational" organization. Common features of these two models were: a) the high levels of integration and localisation that had to coexist together in firms; b) the MNC was seen as a firm with multiple centres integrated by cross-unit ties with the headquarters; and c) the integration of the different units was achieved by means of normative controls, shared experience, and internal variety (Westney and Zaheer, 2001).

Ghoshal and Bartlett (1998), for instance, developed a typology of three ideal-types of organisational structures of MNCs, together with a fourth type, which they argued is the ultimate and most advanced form taken by firms. The first is the multinational model, according to them the most widespread type. It is characterised by a decentralisation of operations to allow the local units to respond to national market differences. The main devices of control in these firms are achieved through personal relationships between top corporate management and subsidiary managers, simultaneously with the implementation of financial controls. The strategic view of the operations of the MNC is a portfolio of national businesses.

The second model is the international organisational model. This structure involves more control by the headquarters over the subsidiaries' operations. There is an important flow of information, knowledge and expertise from the centre to overseas units. While local units are free to adapt the new products and strategies to the local environment, they are dependent on the parent company for new inflows of these. These companies have developed sophisticated management systems that provide regular information to the centre, which facilitates control over subsidiary decisions but at the same time allows delegation. In this type of MNC, the subsidiaries are appendages of the parent operations, whose main objective is to leverage the capabilities and resource developed in the home market.

The third type is the global organisation. This ideal model is recognised by the centralisation of assets, resources and responsibilities. The operations abroad are used to reach foreign markets in order to create economies of scale. Activities in the subsidiaries are usually limited to sales and service: their main role is to assemble or sell products and to implement policies and plans developed at headquarters. Compared to the other two models, the subsidiaries have less freedom in this organisational structure. This implies that local market conditions tend to be ignored and the possibility of local learning is low. The subsidiaries are tightly controlled, with centralisation of decisions at the corporate level.

Finally, the last type is the transnational model. This model integrates the strengths of the three models described above and overcomes their weaknesses. The organisational form is more like a network structure, in which there are some activities that are best centralised at the headquarters and others which are decentralised in subsidiaries. The dispersed operations are integrated through strong interdependencies, which are more reciprocal than sequential. This type of structure balances the demands of integration and localisation of the subsidiaries' operations. In terms of control, they vary according to the subsidiary role, which can be to supply local markets or to develop products for other subsidiaries. The different roles adopted by the subsidiaries imply the use of more varied and complex mechanisms to manage operations.

In the same stream of study of MNCs, the institutional theory defends the opposite idea from the assumption of an evolution in the MNC organisational form to a single model. Its main argument is that specific institutional contexts shape the forms, practices, and processes adopted by firms. When firms become international, they carry with them this heritage from their home country, affecting their selection of how to internationalise. Hence MNCs do not converge on a single organisational model; there is a continued diversity and divergence between firms from different institutional origins. Whitley (1992a) has pointed out that in order to understand the nature of managerial structures and practices in diverse environments, it is important to look at the institutional contexts for explanations of the forms and strategies adopted by firms. Different institutional backgrounds shape firms' operations in general and their internationalisation in particular. Thus, the structure and the strategy of firms adopted as they internationalise are varied, and are moulded by national institutional settings in the parent country.

The internationalisation of firms, however, implies that they have to organise across different institutional settings which set challenges to the original patterns of the actions of firms. As Morgan (2001) has pointed out, there is a complexity of MNCs associated with their multiple sites of production, different types of managers and workers, and the economic processes that need to be coordinated across borders. Therefore, it is increasingly important to study how these features are managed in different MNCs. The coordination needed to organise the diversity of MNCs' operations is reflected in the internal management system of the firm, especially in areas such as the internal organisational structure and the system of monitoring and accountability. This debate highlights the fact that the study of MNCs should consider the influence of the origins of the MNCs in their operations, but also that there are other factors associated with the internationalisation process that should be incorporated in their analysis.

The study of MNCs can take two organisational forms as the unit of analysis: the whole firm or the subsidiaries. There is an increasing tendency in the study of MNCs to look at subsidiaries as the unit of analysis. Two changes in the way that MNCs have been understood underlie this shift. First, the change from a hierarchical view, in which there is only a centre of power, to a heterarchical view of these firms, in which there are many centres of power in the MNC. Secondly, the recognition of the effect of contexts on the operations of MNC subsidiaries, which in turn opens the possibility of variations among MNCs and in the role of subsidiaries within the same MNC. There is an emerging area of study which has concentrated on the analysis of subsidiary strategy, organizational roles, and the development of capabilities at this level. Different theoretical frameworks have been chosen to support the findings. Rugman and Verbeke (2001), using the transaction cost-based theory and the resource-based view of the firm, have created a framework to study the development of subsidiary-specific advantages. Other authors, for instance Birkinshaw and Hood (1998), also using a resource-based view, have developed a typology to analyse the changes in the stock of capabilities of the subsidiary and charters according to the subsidiary ability to add value.

1.3 The Management of MNC Subsidiaries

Over the years, there have been different streams of thought in the international business literature that have become increasingly interested in the study of MNC subsidiaries. "Subsidiary" is defined here to be any operational unit controlled by the MNC and situated outside the home country (Birkinshaw, 1997). Increasing interest in the operations of subsidiaries is linked to the recognition of the power of the subsidiary to accept or reject impositions from corporate offices and to the strategic value of some subsidiaries in the MNCs' operations. On one hand, there is evidence on the role played by some of these units in the generation of knowledge and innovation. On the other, they might develop capabilities which demand large amounts of the resources from the rest of the company. Birkinshaw and Hood (1998) have highlighted the fact that in spite of the attempts to study influential and resource-rich subsidiaries, there is a lack of systematic research on the subsidiary dynamics in different contexts. In the next section, there is a review of the evolution of the MNC subsidiary literature, looking at the different streams of research that have focused their study on MNC subsidiaries.

1.3.1 The Headquarters-Subsidiary Relationship Stream of Research

Research into the nature of the relationship between the headquarters and the subsidiary was the first stream to give explicit attention to the MNC subsidiary. The main focus of this stream was to analyse how the centre controls its subsidiaries, using a hierarchical perspective in which, the subsidiaries were seen as instruments of the centre to expand operations. Issues of centralisation and formalisation of decision-making in MNCs (Gates and Egelhoff, 1986), types of control mechanisms implemented in MNC subsidiaries (Martinez and Jarillo, 1989) and factors that affect the coordination and control activities between the headquarters and the subsidiaries (Picard, 1980), among others, were the main issues researched in this stream.

An important issue that emerged from the study of the headquarter-subsidiary relationship was the influence of internal contextual factors, such as subsidiary size, dependence on resources from the centre, subsidiary time of operation or product diversification on the existence of different control mechanisms in MNC subsidiaries (Youssef, 1975; Gates and Egelhoff, 1986; Welge, 1981). Cray (1984), in his study of 57 subsidiaries of 34 American MNCs, found that control and coordination mechanisms respond to a set of organizational variables. A subsidiary large in size, technologically complex, located in a product division, is very likely to be integrated with the rest of the MNC, but at the same time operates with high levels of autonomy. By contrast, a small subsidiary sharing simple technology with its parent unit, located at a long distance from the centre is subjected to higher levels of control and lower levels of coordination. As a conclusion from the study, Cray supports the proposition that control is more responsive to internal contingencies faced by the subsidiary, and that the coordination activities respond to the complexity of the internal system of the firm.

Another stream in the headquarters-subsidiary literature argues that the relationship between the centre and the local unit should be differentiated according to the contextual circumstances faced by the subsidiary (Rosenzweig and Singh, 1991; Gupta and Govindarajan, 1991; Baliga and Jaeger, 1984). These studies consider the environment as another variable that affects the relationship between the centre and the local units. Rosenzweig and Singh (1991), for instance, argue that MNC subsidiaries face dual pressures: they are pulled to achieve isomorphism with the local environment, but at the same time they face an imperative for consistency within the organisation. Therefore, the pressures imposed by environments on organisations are not uniform, and different relationships between the headquarters and the subsidiaries occur because of these isomorphic forces.

Prahalad and Doz (1981) developed a classification for the HQ control over the subsidiary strategy according to the nature of the organisational context and the extent of dependence of subsidiaries on headquarters for strategic resources. In the same line of thought, Ghoshal and Nohria (1989) hypothesized different relations between the centre and subsidiaries according to the levels of local resources and the degree of environmental complexity. These authors identified differences in the way that headquarters relate to the different subsidiaries. According to Paterson and Brock (2002) this stream of research undertook the initial steps towards accepting that subsidiaries may have considerable autonomy and influence. It also began to emphasize heterogeneity within the MNC, with subsidiaries featuring different characteristics within the same organisation.

In sum, the nature of the headquarters-subsidiary relationship has been studied by focusing on different aspects. However, there are common assumptions underlying the study of this relationship. Firstly, the relationship between the two is influenced by a combination of the objectives of headquarters, which seek integration in order to develop economies of scale, or to support knowledge transfer; and pressures from the local environment where the subsidiary operates, which look for localisation. Secondly, there are differences among subsidiaries of the same MNC. Therefore, the headquarters may relate in a different way with each subsidiary according to contingent internal factors and the nature of the context of subsidiary operations. Thirdly, the relationship between the two parts evolves over time and in a different way with each subsidiary. Thus, to achieve a clear understanding of the nature of the relationship between the MNC and its different units, the analysis should be moved down to the subsidiary level.

1.3.2 The Subsidiary Role Stream of Research

This stream has concentrated its research on the MNC subsidiary as the unit of analysis, allowing authors to take a detailed look at the strategic roles of MNC subsidiaries. Bartlett and Ghoshal (1998, 1986) defend the idea that each subsidiary has a unique role to play in the MNC strategy. This assumption has resulted in a number of typologies of the subsidiary role. These classifications, in an implicit or explicit way, bring two dimensions into the analysis. They tend to be a comparison between the levels of subsidiary autonomy and headquarters control, and the degree of integration of the subsidiary with the rest of the firm. Different typologies of subsidiaries' role have been developed to capture the variety of scope, activities, responsibilities, and strategies of the MNC subsidiaries (Ghoshal and Bartlett, 1998; Taggart, 1998; Birkinshaw and Morrison, 1995;Gupta and Govindarajan, 1991; Jarillo and Martinez, 1990; D'Cruz, 1986; Bartlett and Ghoshal, 1986; White and Poynter, 1984). Many of these studies explicitly consider the ability of the subsidiary to take independent or autonomous action. Table 1.1 summarizes the main classifications of subsidiaries, considering a three-item typology according to the main activities of the subsidiary.

Table 1.1 Typologies of Subsidiary Roles

Authors	Local Environment Adaptors	Contributor Role	Global Responsibility
White and Poynter (1984)	Miniature Replica	Rationalized Manufacturer, Product Specialist	Global Mandate
D' Cruz (1986)	Branch Plant	Globally Rationalized	World Product Mandate
Bartlett and Ghoshal (1986)	Implementer	Contributor	Strategic Leader, Black Hole
Jarillo and Martinez (1990)	Autonomous	Receptive	Active
Gupta and Govindarajan (1991)	Local Innovator, Implementor	Global Innovator	Integrated Player
Roth and Morrison (1992)		Global Rationalisation Subsidiary	Global Subsidiary Mandate
Birkinshaw and Morrison (1995)	Local Implementer	Specialised Contributor	World Mandate
Taggart (1997)	Autonomous, Quiescent	Receptive	Constrained, Independent

Adapted from Birkinshaw and Morrison (1995).

The work of Birkinshaw and Morrison (1995) has differentiated the typologies according to the main activities of the subsidiary. When the primary activity is to adapt products and services to the needs of local markets, when they are limited in their geographical scope and when there are severe limitations to carrying out value-added activities, the subsidiaries are local environment adaptors. White and Poynter (1984) name this type a "miniature replica" subsidiary: in this situation the entire range of value-adding activities is in the subsidiary. Other authors, using different definitions, also refer to this type of subsidiary. Jarillo and Martinez (1990) use the term "autonomous". They argue that this type is typical of "multinational" firms that are competing in "multidomestic" industries. Gupta and Govidarajan (1991) call them "local innovators" and Birkinshaw and Morrison (1995) name them "local implementers". For Bartlett and Ghoshal (1998), they are "implementers". For the latter authors, this type of subsidiaries does not have strategic value for the MNC. They are not responsible for value-added activities. However, they have a commercial value because they make it possible for the MNC to capture economies of scale and scope.

The second broad classification refers to those subsidiaries that have considerable expertise in certain specific functions or activities: they have a specialised role or they contribute to execute certain activities or functions (Quintanilla, 1998). However, these activities are highly coordinated and integrated by headquarters (Birkinshaw and Morrison, 1995). Jarillo and Martinez (1990) name them "receptive" subsidiaries. They use two dimensions to classify this type: the geographical localisation of activities and the level of integration between the activities performed in the subsidiary, and the same activities performed in other subsidiaries. They also point out that "receptive" subsidiaries are typical of global firms competing in global industries. Bartlett and Ghoshal (1986) describe these type of subsidiaries as contributors. They are characterised by having a distinctive capability. Thus, integration with the rest of the MNC is required to take advantage of the capabilities developed locally.

The last group of subsidiary types with global responsibility is formed by units that have worldwide or regional responsibility for a product line or an entire business activity; usually they are not constrained in product scope and have a broad value scope (White and Poynter, 1984). Birkinshaw and Morrison (1995) state that these subsidiaries have achieved decentralisation-centralisation: activities are integrated globally, but managed from the subsidiary, not the head office. "Active" subsidiaries is the name given by Jarillo and Martinez (1990) to units that are in charge of many MNC activities that are carried out in close coordination with the rest of the firm, representing an active node in a tightly knit network. In Bartlett and Ghoshal's study (1998; 1986), they are classified as a "strategic leaders". They act as a partner of headquarters in developing and implementing strategy.

This review has presented a distinctive set of classifications of subsidiaries according to the type of activities carried out in them. However, they do not capture the evolutionary nature that the subsidiary role might have. According to Birkinshaw (2001), it has been recognised in the international business field that foreign direct investment is a sequential process: frequently, the initial investment leads to waves of additional investment. Over time, these flows of investment and resources affect the subsidiary role, thus changing the nature of the subsidiary operations.

1.3.3 The Subsidiary Development Research Stream

Research on how the process of sequential investment affects subsidiary operations and subsequently the subsidiary role is recent. Chang (1995), for instance, points out that there is an incremental process of investment in Japanese MNC subsidiaries that affects the subsidiary role over time. Malnight (1996;1994) highlights the adoption of a different role by the subsidiary with the adoption of a network-based MNC structure. There is documentation of case studies that highlights various aspects of subsidiary evolution (see detailed accounts of cases, Birkinshaw and Hood, 1998}.

Discussion of the development of the subsidiary has taken two perspectives: on one hand, external factors to the local unit are the main drivers of this evolutionary process, such as environment forces and investment from corporate offices (Chang 1995; Malnight, 1994). On the other, internal factors within the subsidiary, such as the initiative of subsidiary managers, are the main drivers of this development (Andersson, Forsgren, et al.. 2001; Birkinshaw and Hood, 1998; Birkinshaw, 1997). However, it seems that this development is a combination of the two factors, in which corporate offices have an important role in supporting the subsidiary development but there is also a level of subsidiary initiative in such development (Andersson, Forsgren, et al. . 2001; Rugman and Verbeke, 2001; Birkinshaw and Hood, 1998).

Birkinshaw and Hood (1998) have developed a model of subsidiary development emphasizing three main drivers. The first one is head-office assignment. It is linked to changes in factors such as the internationalisation of the MNC, subsidiary resource availability, internal competition between subsidiaries and the global environment. The initial decisions of headquarters managers to allocate activities to the subsidiary are in this category. The second driver is subsidiary choice, which includes the desire of subsidiary managers to increase autonomy, the entrepreneurial actions of subsidiary managers, and increased network value. Local environment is the third driver. It is related to the characteristics of the environment in which the subsidiary operates, and is a source of opportunities and constraints. Customers, competitors, suppliers and government entities are part of this local environment.

The two authors argue that the three drivers interact and are the main determinants of the subsidiary development. In a process of action and reaction they become the forces of change on the subsidiary role, which is reflected in the evolution of the subsidiary. They define subsidiary evolution as "the result of an accumulation or depletion of capabilities over time". These capabilities can be understood as charters: businesses or business areas in which the subsidiary participates or has responsibility within the MNC (Galunic and Eisenhardt, 1996).

According to the change in the subsidiary capabilities and its effect on the subsidiary charter, Birkinshaw and Hood (1998) developed a typology of five generic processes of subsidiary evolution. They are presented in Table 1.2.

Table 1.2 Five Types of Subsidiary Evolution Processes

Subsidiary Evolution Process	Action	Outcome
Parent-driven Investment (PDI)	Headquarters take the decision on investment: evaluation of different locations	Establishment of new charter in subsidiary. Development of new capabilities
Subsidiary-driven charter extension (SDE)	Subsidiary identifies new opportunities and builds the capability. It makes the proposal to headquarters	Extension of subsidiary charter
Subsidiary-driven charter reinforcement (SDR)	There is the need to increase subsidiary's competitiveness with other local units and competitors as well.	The result, if the process is effective, is to reinforce subsidiary existing charter
Parent-driven divestment (PDD)	The corporate offices take the decision to divest. Evaluation of various locations	Diminution or loss of the subsidiary charter. Atrophy of the existing capabilities
Atrophy through subsidiary neglect (ASN)	There is inaction from the subsidiary. Atrophy of capabilities and loss of competition	Loss or diminution of charter in the subsidiary

Source: Birkinshaw and Hood (1998).

In the analysis of subsidiary development, there are two main points that it is important to discuss. Firstly, it is assumed that the nature of the subsidiary role is not static. The role of the subsidiary can change over time in different directions: the subsidiary can increase its charter and its value for the MNC or can lose it, affecting its role in the firm. Secondly, there is a combination of different factors that in turn play a role in the evolution of the subsidiary. Some of the factors that might affect this evolution are external: decisions of corporate offices on the one hand, and pressures and opportunities from the environment in which the subsidiary operates on the other. The other group are internal to the subsidiary, linked to the decisions of the subsidiary managers, such as to develop initiatives at subsidiary level that can affect the relationships between subsidiary and headquarters and across subsidiaries. The concept of subsidiary development reinforces the idea that the study of subsidiaries is a complex task, which requires the integration of different levels of analysis to develop an accurate picture of the nature of their operations.

An area in which the development of the subsidiary is reflected is in the control mechanisms implemented at this level. The role of the local unit and the strategy that it develops impact the relationship between the headquarters and the subsidiary, which influences in turn the forms of controlling and monitoring the subsidiary operations. In addition, the strategy of the MNC is grounded in the subsidiary through the implementation of devices that align the subsidiary performance with such strategy. Therefore, it is important to study the implementation of control mechanisms in MNC subsidiaries in order to understand how an MNC implements its strategy at the subsidiary level but also to investigate which are the forces that affect the configuration of these devices in MNC subsidiaries.

1.4 Control Mechanisms in MNC Subsidiaries

The study of control mechanisms has attracted the attention of many scholars. The Aston studies, which were concerned with the study of organisational characteristics, identified a set of variables that influence the configuration of organisations (Pugh, Hickson, et al. . 1969;1960;1950). Variables related to forms of control such as specialisation, standardisation, formalisation and centralisation were identified as shapers of the structure of organisations.

Further studies developed definitions for control activities. Control has been defined by Ouchi (1977: 97) as "a process of monitoring, evaluating, and rewarding, and the data which are processed by this system may consist of measures of behaviour and outputs". Another definition of control is from Child (1984) that states "control within organisations is a process whereby management and other groups are able to initiate and regulate the conduct of activities so that their results accord with the goals and expectations held by those groups". A more general definition is presented by Das and Bing-Sheng Teng (2001:258) : "Control is generally viewed as a process of regulation and monitoring for the achievement of organizational goals".

Common elements in the definitions of control are, on one hand, that control systems are designed to control behaviours of individuals and the outputs generated by those individuals, and on the other, that control devices are aligned to a set of strategic goals. Thus, control system may respond to forces both the strategic and operative levels.

The achievement of organisational goals is also linked to issues of coordination among the different parts of the organisation towards those goals. Martinez and Jarillo (1989:490) defined a coordination mechanism as "any administrative tool for achieving integration among different units within an organisation". Following the same line of thought, Van de Ven et al. (1976) affirm that "coordination means integrating or linking together different parts of an organisation to accomplish a collective set of tasks". Coordination is a recent term which became popular when it was found that in organisations activities such as specialisation and the division of labour need to be balanced with the integration of the different areas of the firm.

The definitions of control and coordination are intertwined. Control mechanisms are the devices designed to support coordination and the achievement of organisational goals. Some authors, such as Martinez and Jarillo (1989), use the terms of control and coordination as interchangeable. Ghoshal and Bartlett (1998) and Edström and Galbraith (1977) define them as control and coordination mechanisms. Others define as control mechanisms some coordination activities carried out within the firms (Marschan, Welch, et al.. 1996;Lawrence and Lorsch, 1967). For the purposes of this thesis. control mechanisms are conformed by those devices designed to control the behaviour of individuals, the outputs that result from the actions of these individuals, and also those devices created to support coordination among the different units of the firm.

Control mechanisms have been classified in many ways. The reason to use different types of control and coordination mechanisms in MNCs is an issue that has been addressed by several scholars in the area of business studies. Different classifications of these mechanisms have been developed (Harzing, 1999; Ghoshal and Bartlett, 1998; Hennart, 1991; Martinez and Jarillo, 1989;Child, 1984).These classifications, generally, are built on two dimensions: one is the dimension of formal/structured or informal/subtle control mechanisms {Marschan, Welch, et al. 1996; Martinez and Jarillo, 1989; Baliga and Jaeger 1984); and the second dimension is linked to the nature of the device; personal and direct or, by contrast, impersonal and indirect (Hennart, 1991; Edström and Galbraith, 1977; Ouchi 1977).

Under the dimension of formality/informality, for instance, Martinez and Jarillo (1989) offer two broad classifications of control mechanisms. They classify as formal mechanisms: the organisational form of the firm, centralisations of decisions, standardisation and formalisation of procedures and norms, planning activities, reports, evaluation of financial performance and direct supervision. By contrast, informal mechanisms are those activities such as cross-departmental relations, informal communications, and socialisation activities among the members of the organisation. Baliga and Jaeger (1984) combine the formal and informal dimension with another, the object of control (output/behaviour). They identify four types of controls: formal performance report, company manuals, shared norms of performance, and philosophy of management. On the other dimension; personal and impersonal, there is Ouchi (1977), with a classification that differentiates the control of behaviour or output and the implementation of other types of control called "ritual", to be used when it is difficult to measure output or to identify behaviours to change or reinforce. Edström and Galbraith (1977) identify three types of control in MNCs: firstly, personal and direct types of control exerted by expatriates in the subsidiaries; secondly, an indirect type of control through indirect bureaucratic methods; and a third type of control by socialisation, which means that individuals learn and internalise behaviours and rules, obviating the need for procedures and hierarchical communication.

Child (1984) developed a more elaborate approach to control activities in organisations with the creation of four strategies of control. Those strategies of control were originated from his previous studies replicating the Aston Study (Child,1973;1972). He combined variables such as centralisation-delegation, formality-informality, and the degree of supervisory emphasis. The four strategies are: personal centralised, bureaucratic, output and, cultural controls. The adoption of each strategy, and how they are combined, varies according to the circumstances that the organisation is facing. Child justifies the presence of each strategy of control through contingency elements such as firm's size, levels of delegation required, nature of the task and educational background of the members of the organisation.

Harzing (1999) has developed according to two dimensions, direct or indirect and personal or impersonal mechanisms, a classification of control mechanisms in MNCs incorporating the different types presented here. The author assumes that control mechanisms in an explicit or implicit way are designed to control behaviour: the difference lies in how the control is exerted, which can be personal or impersonal. Her classification also considers the nature of the mechanism: whether it is designed explicitly to control activities or behaviour or it is created for another function and implicitly supports control activities within the firm. Harzing's (1999) two dimensions are:

• *Personal and impersonal types of control*: the former type is founded on social interactions among the people. The latter is based on devices that are used to control behaviour.

• *Direct or indirect types of control*: direct control is designed to impact individuals' behaviour explicitly (e.g. through norms and procedures). By contrast, the indirect type of control attempts to control behaviour indirectly and implicitly.

The combination of these two dimensions creates four types of control mechanisms which are shown in Table 1.3.

Table 1.3 Classification of Control Mechanisms in Two Dimensions

	Personal/Cultural	Impersonal/Bureaucratic/Technocratic
	Personalised Centralised Control	Bureaucratic Formalised Control
Indirect/Implicit	Control by Socialisation and Networks	Output Control

Source: Harzing (1999).

Output Control

The focus of this mechanism is on outputs rather than behaviour. A distinctive characteristic is that instead of focusing on a specific pattern of action that must be followed, there are certain goals, results or targets which are specified and need to be achieved by employees. Ouchi (1977), for instance, classifies as output control the control exerted through the identification of targets to be achieved by employees. Output-based is another type of control defined by Hennart (1991), which falls into this category. When the reward of the employee directly relates to his output and not to his behaviour, the main target of the control is the output generated by the employee. Martinez and Jarillo (1989) consider financial performance, technical reports, and sales and marketing data as output controls. In line with this, the performance reporting system, whereby subsidiaries submit different data to headquarters, is classified as an output control by Egelhoff (1984). Other activities related to the legitimisation of past action are also classified in this category, such as the use of "responsibility accounting" systems (Child, 1984), and moulding future action, such as strategic and operative planning, and budgeting (Martinez and Jarillo, 1989).

Bureaucratic Formalised Control

The aim of this type of control is to influence the behaviour of individuals through impersonal devices. The most characteristic features of this category are written definitions of jobs, procedures and rules to follow. Often, they are associated with standardisation of procedures, used as patterns to implement bureaucratic control, which helps in taking decisions on standard information about work organisation. Child (1984) argues that this type of control permits the superior levels to delegate without losing control over what is going on. It allows delegation of decision-making within a predefined framework. Edström and Galbraith (1977:250) refer to it as "a mechanism to control behaviour indirectly by relying upon procedures and records as methods for limiting discretion". In the category of structural and formal mechanisms, Martinez and Jarillo (1989) have one subcategory of formalisation and standardisation, which includes devices such as written definitions of jobs, procedures and rules to follow presented previously. Ouchi (1977) and Baliga and Jaeger (1984) also define a category of bureaucratic controls. The former author focuses on the understanding of process before exerting direct control on behaviour. The latter authors address the utilization of a limited and explicit set of rules, which delineates desired performance and regulates the behaviour of individuals. According to Harzing (1999), the large size of MNCs would cause them to rely on a considerable number of bureaucratic formalised controls to manage the operations of subsidiaries.

Personalised Centralised Control

The mechanisms of control that belong to this group refer to centralisation of decision-making at the top level of the organisation and the use of personal surveillance to follow the execution of decisions. In the case of MNCs, the level of autonomy of the subsidiaries on one hand, and the presence of expatriates on the other, are the major examples of this type of control. Hennart (1991) defines as hierarchy control when the control is exerted by explicitly telling the employee what to do, and observing his behaviour to ascertain that he is following orders. Martinez and Jarillo (1989) and Child (1984) label it direct supervision, and centralization/decentralization of decision making through the hierarchy, respectively. Ghoshal and Bartlett (1998) argue that centralisation is a mechanism to support coordination in MNCs. By leveraging the firm and the management resources that are at headquarters, rapid decision-making is facilitated at the top level. Edström and Galbraith (1977) point out that the presence of expatriates in subsidiaries might correspond, among other reasons, to a type of control that is personal and direct.

Torbiorn (1994) highlights three reasons to use expatriate managers in MNC operations: needs of control, requirements of coordination, and the creation of mechanisms to facilitate knowledge transfer. The first category is the use of these managers when there is a strong need to control operations in the local site, because there are high levels of investment, important research and development activities or because the level of control required cannot be achieved by other means. The second reason is coordination activities. High levels of interdependency between activities such as the production of parts of a product carried out in different sites create demands for integration. These activities require mutual and constant adjustment, and the expatriates facilitate this integration. The third reason, knowledge transfer, deals with the transfer of these managers because of the lack of specific knowledge in the subsidiary context. The shortage can arise because of the weakness of the host country's educational system or because of requirements for specific knowledge.

Control by Socialisation and Networks

This category, according to Harzing (1999), is very broad. It combines mechanisms that do not control fixed targets, are not bureaucratic, and are neither direct or very formal. The author identifies three sub-groups within this cluster.

Socialisation: the firm may use other devices to support the cohesion of the organisational group, such as statements on organisational vision and mission. Advances in technology have also facilitated the use of communication tools to support the development of a corporate culture in MNCs. Some authors highlight the relevance of the selection process as a mechanism to support socialisation (Hennart, 1991; Child, 1984;Baliga and Jaeger, 1984; Ouchi, 1977). This type of mechanism seeks to support a homogeneous organisational culture, looking that the personnel share the same organisational values and goals. Members of the firm thus become socialised into the same culture, which provides cohesion to the group. The presence of expatriates in MNC subsidiaries can support socialisation as a type of control. As Edström and Galbraith (1977) point out, international transfers are channels to support organisational development in MNCs. The expatriate managers are acculturated in the company way of doing things, which they carry with them to the subsidiary. The transfer of these managers disseminates the decision-making style that assures the correct function of the structure.

Formalised Lateral or Cross-Department Relations: this sub-category also refers to the exchange of information, but through temporary formal groups such as task forces, cross-functional teams, integrative departments and committees (Martinez and Jarillo 1989). Short transfers of expatriate managers to subsidiaries are also in this category. Another example of these devices is the recent creation of "virtual teams" composed of members from different subsidiaries, who work together for a period of time without knowing each other and use communication tools to carry out the work.

Informal, Lateral or Horizontal Exchange of Information: non-hierarchical communication makes it possible to compare performance and other issues. It acts as a subtle way to control operations. Activities such as training, corporate and regional meetings, and management transfers, help to develop informal networks that support informal communication and coordination among the MNC personnel (Marschan, Welch, et al., 1996;Martinez and Jarillo, 1989).

1.5 The Existence of Control Mechanisms in Organisations

The previous classification of control mechanisms does not mean that the existence of one mechanism inhibits the presence of another. The assumption is that MNCs may implement different combinations of them. The occurrence of such devices is explained in different ways by different authors. They can be classified roughly into four strands.

The first strand uses a contingency approach as a source of explanation for the existence of specific combinations of control mechanisms. Particular circumstances of the environment and organisational dynamics explain the selection of these devices. An assumption of this stream is that there are no universal principles which can guide their implementation. Child (1984), for instance, defines contingent factors such as types of markets, employee skills and experience, environmental variability, task characteristics, and size of the organisation, as the shapers of the control devices elected by organizations. Authors of the headquarters-subsidiary relationship research stream often explain the existence of specific control devices with similar contingent variables (Gates and Egelhoff, 1986;Baliga and Jaeger, 1984; Egelhoff, 1984; Cray 1984). Taggart and Hood (1999), in their study of German and Japanese subsidiaries in the United Kingdom (UK) and Ireland, found that highly autonomous subsidiaries were smaller and had high local responsiveness. Low levels of autonomy of the subsidiary were linked to a globally integrated and faster-growing MNC. Harzing (1999), in her study of control mechanisms in MNCs, also found that contingent variables such as size, interdependence, uncertainty, and heterogeneity/diversity were explanatory variables for the differences in control mechanisms found in MNCs. In sum, the contingency approach explains the existence of these mechanisms to variables linked to the industry of operations of the MNC and to features of the organisation itself.

The second stream of study associates the different types of control with an evolutionary process of MNCs. Martinez and Jarillo (1989) defend the idea of evolution in the presence of control mechanisms. They review research on control mechanisms from 1952 to 1988, and show the change from a previous concentration on the study of formal and personal mechanisms to an extension of the research that examines the more informal and subtle ones. The explanation for the shift in the academic research is a consequence of evolution in practice. The context of the firms is changing, making more complex their operations and compelling them to adopt less hierarchical forms with a decentralisation of operations and the adoption of "network" based international operations. There is an increasing demand to control operations by other more subtle and informal means than the traditional ones: more formal and personal. Edström and Galbraith (1977), in their analysis of control mechanisms in MNCs, defend the idea that control strategies are accumulative, not alternative mechanisms. Firms tend to use different combinations of control strategies that are complementary.

The third stream studies the selection of these mechanisms in MNCs according to the country of origin of the firm. Authors within this group argue that the country of origin of the MNC determines the selection of control devices. Early studies of control mechanisms identified differences in the control strategies of firms according to the country of origin of the MNC (see, e.g., Egelhoff, 1984). Ghoshal and Bartlett (1998) identify different mechanisms of control according to the country of origin of the MNC. For instance, centralisation of decision-making in headquarters is a typical pattern of Japanese MNCs. By contrast, US companies rely more on formalisation and standardisation of procedures as control devices, allowing more decentralisation of decisions to the subsidiaries and European MNCs rely more on socialisation. The dominant coordination process is through the recruitment, selection, and acculturation of key decision-makers.

Harzing (2001) points out differences according to the country of origin, analysing the reasons for international transfers in MNCs. American and British subsidiaries use expatriate managers to control operations abroad in less degree than their Japanese and German counterparts. The former rely more on output and bureaucratic controls. Research on German MNCs has found that they rely more on bureaucratic and personal forms of control to manage their operations abroad (Ferner and Varul, 2000; 1999;Neghandi, 1983). Harzing and Sorge (2003), in their study of the country of origin effect in the implementation of organisational practices in MNCs, found that the presence of control devices is clearly and directly related to the country of origin of the MNC. This stream of study focuses its analysis at the national level: its main assumption is that the presence of specific control devices in MNCs lies in the effect of national institutional arrangements on the firm operations.

The last stream of research looks for the existence of these devices in the micro-political activities within the firm. Political processes in organisations are key determinants of the blend of control mechanisms in MNCs (Ferner 2000). A specific combination of control devices reflects the political realities within the firm and the struggle for control and autonomy of different interest groups. There are formal systems of control implemented by the centre, whose main objective is to align subsidiary actions with firm goals. This formal system of control is accompanied by informal controls from the centre, such as the power to approve investments and budgets, and knowledge transfer (technology or personal resources) from the headquarters to the subsidiary. There is a natural tendency of the subsidiaries to reject controls imposed from the centre and to struggle to increase their autonomy. The power of the subsidiary comes from its knowledge of its local context; of markets and institutional settings, and from the initiatives of products and services developed locally, which can be exported to other subsidiaries. The strain created by this struggle between the centre and the periphery is reflected in the implementation of control devices in the subsidiary. Table 1.4 summarises the distinctive elements of each stream on the explanation for the presence of control mechanisms in MNCs.

Table 1.4 The Four Streams on the Explanation of Control Mechanisms in MNCs

Stream of Research	Distinctive Characteristics
Contingency Approach	• The characteristics of the environment and organisational dynamics are the forces that influence the presence of control mechanisms • Focus on the industry and organisational levels
Evolutionary Process Approach	• Evolution of the MNC is key factor to understand the presence of control devices • Focus on organisational level
Institutionalist Approach	• Country of origin is the main factor, which explains the combination of control mechanisms • Focus on national level
Political Approach	• The political process within the MNC are powerful forces, which determines the presence of these devices • Focus on organisational level

This review of control mechanisms in MNCs highlights two interesting points. Firstly, academic researchers have shown substantial interest in the study of the control strategies of MNCs. The initial approach has a hierarchical perspective and was mainly concerned with how the centre should control the operations of the subsidiary to align its behaviour with the strategic objective of the firm. The evolution of the study of MNCs and an increasing understanding of the power of the subsidiary to accept or reject impositions, incorporate into the analysis of control mechanisms in MNCs other variables such as subsidiary size, characteristics of its markets, subsidiary capabilities and nature of subsidiary context.

Secondly, there are various perspectives which have been adopted to investigate the presence of these devices on these firms. Each perspective has focused its analysis on different levels. The contingency theory looks at the industry and intra-firm levels to explain the presence of these devices. In the same line of thought, there is the evolutionary approach, which argues that changes in the environment and structure of firms, due to increasing competition, are reasons for the adoption of subtler devices. The institutional approach mainly focuses on the national level, searching for an explanation of patterns of control in the institutional context in which firms have originated. Finally, the political approach is more concerned with intra-firm processes and how formal and informal relationships of power coexist and affect the existence of these devices in MNCs.

This debate on the reasons for the presence of control mechanisms poses important questions: How do the institutional settings from the country of origin of the MNC and the country of operations of the subsidiary affect the implementation of these devices? What are the explanations for the differences and similarities found in MNC subsidiaries regarding their control systems?
One aspect that has been neglected in the study of control devices in MNC subsidiaries is how the institutions from the country of operations may affect the existence of these devices at subsidiary level. Although there are many

studies of the effect of the host context on the subsidiary role and its development, there is a dearth of studies of how the host context affects the implementation of control mechanisms (an exception is Sharpe, 1997). Apart from considering contingent factors such as the size of local markets and the volatility and complexity of these markets, the effect of host institutions on the implementation of these devices is an area with little research so far.

The main argument of the institutionalist approach, which emphasises that differences in the presence of control mechanisms in MNC subsidiaries is due to the effect of particular institutional arrangements, can also be applied to the country of operations of the subsidiary. Those arrangements influence the operation of the subsidiary, pushing for adaptation to the institutional environment, the implementation of control mechanisms might be affected by it.

According to the literature review presented here, the study of control mechanisms in MNC subsidiaries is a complex phenomenon because of the multiple factors that intervene in their implementation. In this order of ideas, the presence of control mechanisms has received only partial explanations and has been subject to a narrow focus on the analysis of their presence in MNCs. The review of the different streams of research that explain the presence of them highlights the need to analyse them from various perspectives which complement each other. Therefore, it is important to develop an analytical framework that includes various levels of analysis, to capture the complexity of their existence in MNC subsidiaries. A framework, which accomplishes this task, is presented in the next section.

1.6 An Analytical Framework for the Study of Control Mechanisms in MNCs

This section presents a framework to analyse the existence of control mechanisms in MNC subsidiaries. Frequently, MNC research has considered this organisation as a single unit, giving little attention to subsidiaries as particular organisations that are exposed to particular forces. As organisational units, they have their own internal managerial dynamics, which are the result of a combination of resources, capabilities, and managerial decisions in a particular context.

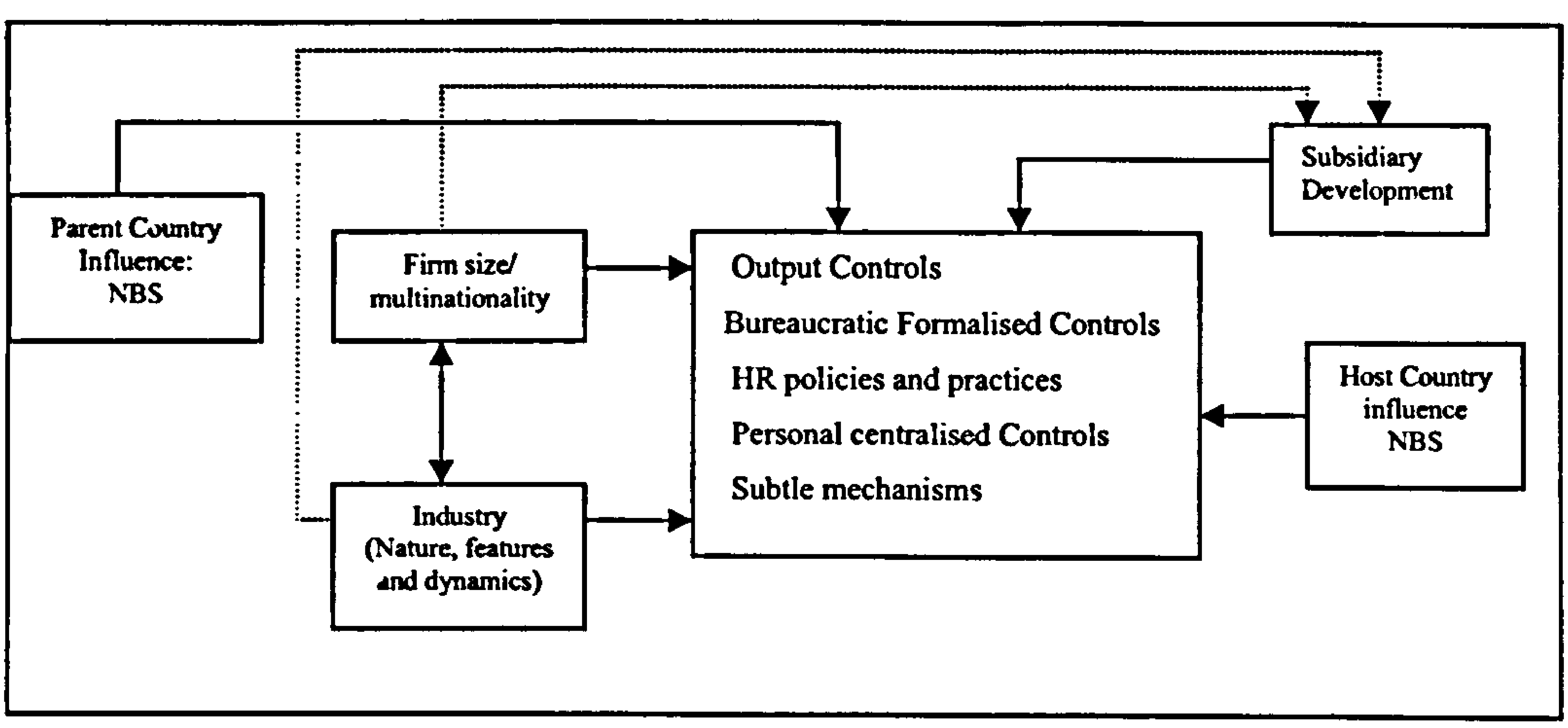
A research model is developed to understand the existence of control mechanisms in MNC subsidiaries. It seeks to integrate the different forces that influence the presence of these devices, according to the literature review. The framework integrates the different elements, which in turn, may also affect the existence of control devices in MNCs. It is used to understand the presence of these devices in the case studies of the thesis, German and British subsidiaries in Venezuela.

The analytical framework is built on the integration of the different spaces in which the subsidiary is embedded. The previous literature review highlighted how forces coming from different levels affect and shape the subsidiary operations and subsequently the presence of control devices. The basic framework presented here has its origin in the integration of these levels, covering simultaneously the firm, the industry, and the countries. It looks to explore how and to what extent the macro level (institutional environments) and the meso level (industry or sector of operations) affect the micro level, which is linked to the operations of the firm, particularly the operation of the subsidiary. A framework that integrates the three levels of analysis is designed to understand the existence of control mechanisms in MNC subsidiaries.

Similar frameworks have been used in management literature, particularly in the international business field (Christmann, Day, et al., 1999; Quintanilla, 1998; Weber, 1995; Canals, 1995; Pettigrew and Whipp, 1991). Christmann et al. (1999) developed a model of determinants of subsidiary performance, incorporating different levels into the analysis: country of operations, industry structure, and firm features such as control exerted by corporate offices, size of the MNC and type of subsidiary strategy. They found that the most determinant factor of subsidiary performance was the characteristics of the country of operations of the subsidiary. Moreover, the host country effect impacted the characteristics of the industry within the country, making a clear distinction of how developing and developed countries may affect subsidiary performance. Quintanilla (1998), in his analysis of the implementation of human resource (HR) practices in German subsidiaries in Spain, incorporates in the national level of analysis, two effects, country of origin and country of operations effects, developing a framework which is built in three levels: national, industry and firm. In spite of these studies, however, there have been few additional attempts to understand the subsidiary behaviour using a multilevel analysis and considering the subsidiary as the unit of analysis (Christmann et al., 1999; Birkinshaw and Hood, 1998; Porter, 1990).

The framework is presented in Figure 1.1. Its application provides an understanding of the presence of control mechanisms in a specific moment of time. The intention of this framework is to give an explanation of the presence of these devices according to a set of factors which emerge from the integration of different levels of analysis.

Figure 1.1 Analytical Framework of the Configuration of Control Mechanisms in MNC Subsidiary



The literature review showed that the existence of control mechanisms in MNC subsidiaries is driven by five forces, three of which affect the whole MNC and two that affect directly the subsidiary. First, there is a set of institutions in the home country of the MNC that determines many aspects of the firm. Second, the firm operates in an industry that has its own dynamics. Third, the MNC has a set of characteristics which are the result of its own evolution which affects the whole operations of the firm. Fourth, the subsidiary has its own development that is shaped by a group of features that affect the whole firm but also by other variables that only influence the local unit. Fifth, there are the host country institutions that impact the operations of the local unit. The existence of control mechanisms in this thesis is analysed according to these driving forces. They are also used to present the case studies in the following chapters of the thesis.

Home-Country Institutions

Whitley (2001) argues that, in spite of the increasing global expansion of firms, they remain influenced by the institutional arrangements of their country of origin. His argument is based on the fact that there is a lack of strongly institutionalised global governance norms that could standardise modes of specific economic coordination, and in this way mitigate the effect of the original economic arrangements in which the firm is embedded. He defends the idea that the characteristics of the FDI of firms, such as where and when they invest, and how they are subsequently managed, are shaped by governance structures and capabilities developed by firms in their home business system. According to this, the management of the international operations of a firm is determined largely by the effect of the home institutional composition, which in turn moulds how headquarters manages the relationship with subsidiaries.

The nature of the corporate offices-subsidiary relationship is reflected in the set of control mechanisms that are initially implemented in the subsidiary. Therefore, the analysis of these devices starts with the identification of the forces from the home business of the MNC, which affect the shape that these mechanisms take, and from there, the identification of potential combinations of them according to the country of origin of the MNC. Chapter 3 presents a framework to analyse this effect, and the characteristics of the home country of the MNCs according to this framework.

Host-Country Institutions

The effect of the home-country institutions on the operations of the MNC has a mirror image, but at subsidiary level. As was discussed, the subsidiary development is determined largely by the condition of the environment of operations. These forces are linked to the characteristics of the market and position of the subsidiary within it, but they are also linked to the nature of host institutions and the predominant economic arrangements there. The increasing debate on the effect of institutional contexts on firms operations assumes that there are also national institutions of the country of operations that affect the operations of the subsidiary. For instance, it is argued that MNCs that belong to arm's length environment (e.g., Britain) may easily adapt to host environments than MNCs which are linked to more coordinated economies (e.g., Germany and Japan) (Whitley, 2001).

Geppert et al. (2003), for instance, argue that national contexts impact the formulation of strategy, on one hand via home country institutions, and on the other, the implementation of this strategy on the subsidiary through host country institutions. The characteristics of the host-country institutions are analysed in Chapter 3 under the same framework discussed above. In addition, Chapter 4 analyses the sector of operations of the MNC subsidiaries in Venezuela.

Industry

The third driving force is the industry. It is important to identify the features of the industry that define competition within it. Dunning (1993) highlights the importance of sector of operation in the path taken by the firm to internationalise. Porter (1986) states that to understand the behaviour of firms, its analysis has to be taken down to the industry level. These forces of competition are connected to elements such as attributes of the product and services, industry life cycle and rivalry between competitors and types of buyers. MNCs operate in an industry that puts pressures on firms to develop strategies and structures to fit with industry characteristics.

Powell and DiMaggio (1991:70) point out that "Organizations tend to model themselves after similar organizations in their field that they perceive to be more legitimate or successful". According to this, there should be a certain level of convergence of firms operating in the same sector. The industry analysis has to be seen as an intermediate level of study between the effect of national institutions on the firm's operations and a more micro level that is focused on the analysis of variations inside the firm. MNCs in the same industry but coming from different environments may show diverse patterns of work organization as a consequence of the distinctiveness of the context where they originate. Nevertheless, isomorphic forces at industry level pull to homogenize, making firms look similar in some of their characteristics. Hence the industry is a space where differences among MNCs due to their institutional background are reconciled, and this might explain the similarities found in control mechanisms in organizations in the same industry, yet coming from different contexts.

MNC International Operations

The fourth driving force responds to one aspect that is interior to the organisation. The growth of international operations of one firm generates an organisational learning, which is inherent to a maturity stage of operating abroad. This learning creates advantages for the firm that are reflected in the development of its capabilities. The development of capabilities brings the implementation of devices which support and reinforce the use of these capabilities as distinctive advantages for the organisation. Several authors have highlighted the influence of size and multinationality on the implementation of control mechanisms in MNCs (Harzing, 1999; Malnight, 1996; Hulbert and Brandt, 1980).

Subsidiary Development

The presence of certain control mechanisms in subsidiaries is intertwined with the development of the subsidiary. The subsidiaries as entities may change their behaviour. They can modify it over time, as was previously discussed in the literature. They are affected by changes in the environment on one hand and by transformations inside the firm on the other. They also develop their own strategy to cope with these demands. Thus, they are in a permanent process of change and evolution.

As was discussed, the fifth driver is the subsidiary's own development. The study of the control devices has to consider the subsidiaries' development to understand their presence in the subsidiary. Following Birkinshaw and Hood's (1998) model of subsidiary development, it is important to study three main drivers that influence the subsidiary. Firstly, the corporate mandate, which is reflected in the reasons to set up a subsidiary in the country. These reasons determine the initial role assigned to the local unit, the initial resources transferred to it and the relationship with the corporate offices. Secondly, it is important to look at the evolution of capabilities and charters in the subsidiary due to actions, initiatives and decisions carried out by subsidiary managers, which in turn may affect the initial role of the subsidiary and consequently the initial mechanisms set up to control its operations. Thirdly, the other area to consider is the effect of the local context on subsidiary operations. This environment is the main source of opportunities and constraints in the operations of the subsidiary. Thus, to capture subsidiary reality, it is important to explore the characteristics of the subsidiary market and how the subsidiary is positioned in this market, which is the aim of Chapter 4.

There are some final comments to be added to the analytical framework presented and discussed here. Firstly, it is important to highlight the fact that there is an implicit assumption that control devices are additive rather than complementary. This means that one firm can have a considerable reliance in all of them or by contrast one firm may rely heavily only on one or two. Secondly, the analytical framework presented above explains, according to the variables described, the existence of control devices in a specific moment of time, implicitly assuming that variations of the variables may affect the current combination of control devices. Thirdly, in Harzing's (1999) typology HR practices were classified as control devices in each of the categories created. However, in the framework developed in this thesis they are grouped as a separate category. The rationale for that is that they have to be analysed as a system to understand their impact as mechanisms of control; if they are investigated separately their overall role in this area may be diluted. It is important to study the interconnectedness and integration of different personnel practices to have a more integrated approach in their study (Hendry, 1996).

1.7 Conclusions

A main point to highlight in the conclusions of this chapter is the complexity of the study of MNCs in general and in particular the implementation of control mechanisms in MNC subsidiaries. The increasing interest in the study of subsidiaries as units of analysis is linked to their added-value to MNC operations. However, their study is an arduous task because of the several forces that influence their operations. Different forces influence their existence, which can be classified at different levels: national (parent-institutions and host-institutions effects), industry, and organisational levels. The latter has to be divided into two sub-levels: organisational, which affects the whole firm; and subsidiary, which only affects the internal dynamics of the subsidiary. All types of forces are reflected in the analytical framework presented in this thesis to study the presence of control devices in MNC subsidiaries.

The intention of this framework is to undertake an analysis that considers a more complete approach with the inclusion of features from different spaces of analysis, which has been often neglected in the study of MNC subsidiaries. The literature review presented in the first part of the chapter has shown how the study of MNCs has shifted from a hierarchical position, where the whole organisation is the unit of analysis, to an increasing interest in the subsidiary as the unit of analysis. This in turn has opened the space to understand subsidiaries as units with their own dynamics, where the centre is another variable that may influence their operations.

An innovation of the integrative framework for analysing the presence of control devices is the incorporation of the effect of the country of operations from two perspectives. First, it includes the market in which the subsidiary operates and how its position within the market affects the development of the subsidiary operations and, in turn, the existence of control devices. Second, the effect of the host environment is not only focused on these features, which have been the common approach: it also integrates the influence of host institutions on subsidiary operations and consequently on the control devices implemented in the subsidiary.

The incorporation of these factors in the study of MNCs, as was discussed in the literature review, has been rare. The thesis aim, with the incorporation of this feature, is to give a more integrated analysis of the existence of these devices and overcome the partial explanations of their presence in MNC subsidiaries, closing the gap in the literature. The next chapter explains how this task is accomplished, and how the analytical framework presented here is applied to the study of MNC subsidiaries to answer the research questions of the thesis.

Chapter 2: Research Methodology

2.1. Introduction

This chapter explains the methodology followed to answer the research questions of the thesis and to develop the analytical framework to study the presence of control mechanisms in MNC subsidiaries. A qualitative methodology, using theory generation from the case study method, is proposed. The theoretical framework incorporates a multilevel analysis, and in-depth case studies are investigated to develop the framework. This chapter has five key sections. First, it presents the philosophical position of the researcher. Second, there is a discussion of the theory generation from the case study method. Third, the framework design and the rationale behind its selection are discussed. Four, the research design is presented, in which, there is a description of the different steps followed. Finally, the main conclusions of the chapter are highlighted in the final section.

2.2 Philosophical Position

The international business area has been researched, frequently, from a positivist position (see for example Kogut, 2001 for a detailed review of research in the area). This influence has cascaded down to the study of the presence of control mechanisms in MNCs, which has taken in many cases a positivist approach. In this sense, much of the research in the area has identified a set of variables which has affected the implementation of these control devices by using a nomothetic methodology (Harzing and Sorge, 2003; Harzing, 1999; Chang and Taylor, 1999; Jarillo and Martinez, 1990; Cray, 1984; Egelhoff, 1984; Baliga and Jaeger, 1984; Ouchi, 1977). The selection of the sample of this research has followed a statistical logic: to obtain as many cases as possible and have a representative sample of the population in terms of its size. The application of quantitative methods has reduced this research to the identification of a set of common variables that explains the presence of control mechanisms in MNCs. This type of research ignores diversity and is concentrated on generalisations, selecting the variables that are common in all cases. Ragin (1989) has highlighted the fact that in this type of methodology the cases of the sample lose their identities and they are disaggregated into variables: the differences among the units of the sample are not relevant. The focus of the analysis is what variables answer the research question, and the development of a model that fits with all cases, resulting in an unequivocal answer to the research question.

For instance, Harzing (1999) in her study of control mechanisms in MNCs used the survey method in 22 subsidiaries from nine HQ countries (USA, Japan, UK, France, Germany, Finland, Sweden, Switzerland and the Netherlands). The research identified a set of variables which influenced the presence of these devices. The positivist bias of the research did not allow this researcher to investigate how and why these variables were affecting the presence of these devices. Moreover, it assumed a constant conjunction of events or laws in any situation, as occurs in the natural sciences, an assumption that in the social sciences has attracted considerable criticism.

A position on the side of critical realism has been adopted in this thesis to overcome the limitations of the positivist view of research in the area. Critical realism has been developed by two contemporary philosophers of social science: Roy Bhaskar (1979; 1978) and Rom Harré (1975; 1972). Critical realism, with its assumptions, overcomes the limitations of the positivist approach, without moving to the extreme of the impossibility of objective knowledge, which defends the position that there is no reality and the assumption that what is known is merely the product of discourses (Ackroyd and Fleetwood, 2000).

There are three basic contentions in this perspective of critical realism. First, social phenomena exist not only in the mind but also in the objective world (Ackroyd and Fleetwood, 2000; Miles and Huberman, 1994). This reality can be understood primarily through the structures and mechanisms of the world, rather than through empirical events (Tsang and Kwan, 1999), and these structures follow a causal criterion through which reality can be explained (Archer, 1998). The position taken by critical realism, in which the social world exists independently of its identification by human beings, takes a middle position between a realist view of the nature of reality and a nominalist position. In this sense, the existence of control mechanisms in MNC subsidiaries is real; however, its analysis focuses on causal relations that explain the existence of these devices, looking at differences and similarities among the units of analysis rather than a set of variables that are common in the cases of the sample.

The second premise is the "transfactuality" of mechanisms (Archer, 1998), which means that the mechanisms and structures are only contingently related to observable and particular empirical events. According to Archer (1998): "if society is only like itself, meaning that it is contingent that any particular social structure exists, then we are committed to providing a particular kind of explanation". This explanation is not concerned with the experiences and perceptions, or with events and actions; by contrast, it looks at the causal mechanisms, powers and relations that are permanent conditions, and at the continually transformed outcomes of human agency (Ackroyd and Fleetwood, 2000). The presence of control mechanisms in MNC subsidiaries is studied under this premise; therefore, to really capture the complex relations associated with their presence, an in-depth method should be used to truly understand how and why these causal connections have developed.

Third, knowledge is a representation of reality; but, it is a partial explanation. Knowledge as universal causal laws governing the social world is almost unattainable (Tsang and Kwan, 1999). The interaction between contextual constraints and individual freedom makes social transformation a continuous process. Therefore, the consequences or outcomes can not be deduced or predicted, what can be achieved are explanations of the causal mechanisms that govern human actions (Ackroyd and Fleetwood, 2000).

In terms of this research, to take a philosophical position on the critical realism side means some assumptions concerning the way in which the research project is carried out. First, the analytical framework developed in the thesis is subject to replication to support or discredit the findings. It is believed by some social scholars that replication is important to validate or disprove propositions or theories in social science (Tsang and Kwan, 1999; Miles and Huberman, 1994; Yin, 1994; Eisenhardt, 1989). However, this replication has a different perspective compared to the replication in the natural sciences. The framework developed in Chapter 1 explains the presence of control mechanisms through causal relationships rather than by predicting their existence. The causal relationships are built on similarities and differences among the units of analysis (e.g., the MNC subsidiaries).

Second, a suitable research method, in accordance with the philosophical position adopted by the researcher, is the case study method. According to Easton (2000) the case study method is a useful tool to describe empirical events and trace links over time, digging deeper; it allows the analysis to move from the actual to the real domain. An important advantage of the case study is the possibility to identify causal mechanisms that underlie the process of the implementation of control devices, asking why they are presented, building causal relations from different sources of data, and collecting data from different actors and incorporating into the analysis different perspectives and perceptions.

Third, there is a comparative aspect in the design of the research. Changes in the nature of social research have moved researchers to pay more attention to cross-national diversity and to contextualise findings (Ragin, 1989). Theories, which are based on nomothetic ideas, have declined in the social sciences with the increasing development of theories and tools that are focused on diversity and causal complexity. Therefore, social research has become more oriented towards comparative research, because diversity is associated with contexts, which in turn stresses the existence of different realities that do not support universal laws. The original idea of the research project was to study the effect of the country of origin in the implementation of control mechanisms in MNC subsidiaries. It was not possible to study this phenomenon through case studies from the same country of origin: the research has to assume a comparative nature, with cases from different countries. The comparison of cases looks for explanations of similarities and differences among them. This aim is aligned with the philosophical position of critical realism, and cannot be achieved by studying cases separately.

2.3 Theory Generation from the Case Study Method

As was stated above, the research methodology followed is the case study method. Yin (1994) states that a case study is a type of empirical enquiry that investigates a current phenomenon within its real context, especially when the boundaries between the phenomenon under study and the context are not clearly evident. The study of contexts through different features (e.g., the effect of the home-country and host-country institutions) implies that its analysis is an important part of the research. The aim of the application of the case method in this thesis is to develop explanations through the analysis of cases. Several processes of the development of theory from the case method have been discussed. For instance, Glaser and Strauss (1967) have designed a comparative method to develop grounded theory. Yin (1994) has defined a set of steps to design case study research. Miles and Huberman (1994) have formalised a number of procedures to analyse qualitative data. Eisenhardt (1989) has outlined a roadmap for building theories from case study research. Finally, Pettigrew (1997) has developed a "processual analysis" which builds theory from the use of longitudinal comparative case study research.

Building theory from case studies is the research strategy followed in this thesis. Eisenhardt (1989) stresses that this strategy is useful when there is the need to provide freshness in perspective to a topic that has been researched extensively (e.g., the existence of control mechanisms), adding new elements to its explanation (e.g,. the effect of country of origin and country of operations), and when the researcher is looking for explanatory relations and the study describes patterns of relations (e.g., a philosophical position on the side of critical realism) (Huberman and Miles, 1994). Table 2.1 shows a process of how to build theory from case study research.

Table 2.1 Stages to Build Theory from Case Study Research

Stages	Activities
Defining the research frame and aims of the investigation	• Theory development • Definition of research questions • Development of conceptual constructs
Selecting cases	• Case study design: unit of analysis and case selection (single or multiple case studies) • Data collection methods • Crafting of instruments and protocols
Conducting fieldwork and preliminary data analysis	• Data collection: gathering different sources of evidence • Data analysis: adjustments to the data collection instruments and protocols
Defining a preliminary analytical framework	• Development of a preliminary framework: the explanation of relationship between the subject of analysis and the initial constructs, and the inclusion of other constructs which emerge from the analysis of the data
Data Analysis	• Within-case analysis and cross-case analysis: reframing the analytical framework • Searching for additional information in the fieldwork
Enfolding Literature	Comparison of the emergent framework with the existing literature (similar and conflicting perspectives)
Reaching closure	• There is a final product in terms of concepts, conceptual framework, propositions or possible mid-range theories • Evaluation of the strengths and weaknesses of the research

Adapted from Yin (1994) and Eisenhardt (1989).

There is a debate on how much shape a qualitative study should have in terms of the pre-existent conceptual framework. There are divergent positions regarding this issue, in the qualitative research. On one extreme, there is the group of anthropologists and social phenomenologists who consider social processes too complex to be approached with explicit conceptual frameworks. They prefer to gather data with no preconceptions and then inductively ground the theory on the findings (Miles and Huberman, 1994). The other extreme defends the idea that the qualitative study needs a tight design: a pre-existent conceptual framework, well-defined research questions and clear interview protocols. Wolcott (1982) clearly defends this position, arguing that "is impossible to embark upon research without some idea of what one is looking for".

Eisenhardt's (1989:536) position is that "theory-building research should begin as close as possible to the ideal of no theory under consideration and no hypothesis to test". Instead of starting with a well-defined framework, she argues that the literature on the subject should help to define possible constructs that, in turn, explain the subject of study. By contrast, Yin (1994) defends the idea that theory development as part of the design phase is fundamental. Miles and Huberman (1994) argue that the researcher should develop some conceptualisations about the phenomena but not a full theory. In this sense, these conceptualisations should help to develop a preliminary conceptual framework or a priori conceptual constructs that help in the development of the research questions and in subsequent stages of the research, such as sampling and data gathering. This research stands with the last position mentioned above. The research project of this thesis defines a preliminary theoretical framework that helps to develop the research questions, and to select the cases. However, through an iterative process of induction (data-driven) and deduction (theory-driven), the analysis of the cases is carried out. The result of this process is the framework presented in Chapter 1. The final result is the development of an analytical framework that arises from this open-ended process. Other researchers, such as Pettigrew (1997), have linked his "processual" analysis to this cycle of deduction and induction to make comparative analysis among case studies.

2.4 The Framework Design

Clark (2000) has stated the need to incorporate different levels of analysis in order to understand, describe and explain the actions of organisations. He defends the idea that the context of operations matters and should be included in the study of firms. The context, according to his view, has to be divided into nations and sector of operations. The latter has to be included because of the importance of understanding the relationship between the peculiarities of the product and how it influences consumption patterns, and how this relationship affects the development of capabilities in the firm to survive and grow. In a previous work, Clark and Mueller (1996) also highlight the importance of incorporating the specificities of the firm to investigate organisations. There is another level to incorporate, the intra-firm level, which has concentrated the majority of attention of research but from a position that has not included the context as other level of analysis (Clark, 2000).

Pettigrew (1997) also argues the value of studying processes in organisations using a number of levels of analysis. He points out the idea that the analysis of the firm's processes should consider the outer and inner contexts. The outer context includes the economic, social, political, competitive and sectoral environments in which the firm is embedded. The inner context refers to the cultural and political environment within the firm that, in conjunction with the outer context, shapes features of the process of the firm.

This research proposes a multilevel of analysis, which incorporates the effect of the context of operations of the MNC in conjunction with intra-firm characteristics. Consequently, there are three levels in this research on control mechanisms in MNC subsidiaries in this thesis. First, there is a national level: the study is focused on the presence of control mechanisms in MNC subsidiaries, and includes features from both the home-country of the MNC and features from the host-country of operations of the subsidiary. There is a second level, which is the analysis of the sector of operations of the MNC and the effect of markets and product features on the operations of firm. The third level is the intra-firm level, which incorporates features from the MNC and the subsidiary, as presented in Chapter 1.

This type of analysis implies that there are changes in organisations and contexts over time which affect each other. According to Clark (2000), this type of analysis takes organisation theory from a universal time-space free solution (a positivist view of knowledge) to the explanation of hidden structures and mechanisms that explain patterns of events, which is consistent with the philosophical position adopted in the research.

In the following sections, the reasons that justified the choices mentioned above are presented, how the fieldwork was conducted is explained, and the analytical tools applied to the data to reach the final analytical framework are described. The theoretical validity of the research and its rigour are also explained.

2.5 The Research Design

As mentioned, the aim of this thesis is to identify the forces that underline the presence of control devices in MNC subsidiaries. The unit of analysis of this investigation is the MNC subsidiary, the case study design is a multiple-case design, and the research framework has a multilevel analysis. The research case selection is four case studies: two from the oil service sector and two from the business software sector, the home-countries of the MNCs are Germany and Britain, and the host-country of the subsidiaries' operations is Venezuela. The focus of the study is to identify the types of control mechanisms implemented in the MNC subsidiaries and explain the reason for their presence. The research investigates the underlining structures and relationships that explain the presence of these devices in the MNC subsidiaries.

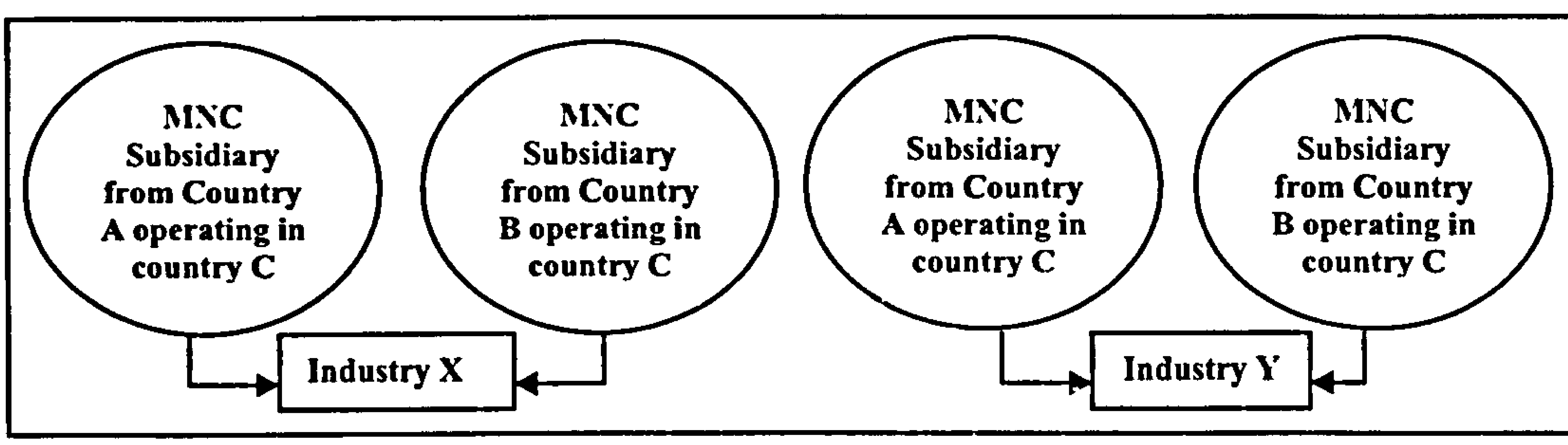
2.5.1 The Preliminary Design

The design of the research took as a first consideration the selection between single or multiple case designs. A distinctive characteristic of the investigation is its interest in the effect of the context (parent-country and host-country effects) on the presence of control mechanisms in MNC subsidiaries. The study of this feature shapes the nature of the research as comparative. In other words, it should incorporate MNC subsidiaries from different countries to clearly identify the parent-country effect on the existence of control mechanisms in the subsidiaries. A multiple-case design is the most suitable option to make this type of comparison. An important advantage of multiple cases is that the evidence from them is often considered more compelling and the study is regarded as more robust (Herriot and Firestone, 1983).

After the decision on the type design, it was important to estimate the number of cases to be analysed. As a preliminary analysis at least two cases were part of the sampling. Yin (1994) argues that one logical idea behind selecting case studies is the selection of cases that envisages contrasting results but for predictable reasons. In this case the selection of MNC subsidiaries from different origins follows this logic; therefore, it was decided to select MNC subsidiaries from two different countries of origin. An innovative approach of the study was the analysis of the effect of the institutions of the country of operations on the presence of control mechanisms. Because of the incorporation of this new feature, it was decided to concentrate the study only on subsidiaries operating in one country: to include more than one country of operation would make the study too complex.

It was also decided to incorporate, as another criterion in the selection of cases, polar types of MNC subsidiaries according to the type of sector of operations to make the sample more robust. Eisenhardt (1989) states that case studies may be chosen to fill theoretical categories and to provide examples of polar types. According to Pettigrew (1997), the selection of polar types helps to construct a much better theoretical argument and to discern the underlying process. In the initial literature review, it was found that an important explanation for the presence of control mechanisms in MNC subsidiaries was linked to contingency factors (Chapter 1 explains this point) therefore, the selection of the cases should consider this feature. The best option was to consider polar types of MNC subsidiaries, from the same country but different sectors. Figure 2.1 shows the logic of the design.

Figure 2.1 Sample Design of the Research



2.5.1.1 Selection of the Country of Origin of the MNC subsidiaries

In the past, as many of the contributors to organisation theory have been located in the US, they have tended to take it as the universal background for the formulation of theory (Searle, 1995). However, recently, international differences have been increasingly acknowledged, and a more international perspective has emerged with more awareness of the different backgrounds (Clark, 2000).

According to Ferner (1997) the majority of comparative literature concentrates on American and Japanese MNCs. The study of European companies usually is carried out by lumping together them as monolithic group and comparing them with Japanese and American organisations. However, many studies of MNCs have highlighted large differences among European countries (Ferner et al., 2001; Ferner and Varul, 2000; Harzing, 1999; Quintanilla, 1998; Lane, 1998; Doremus et al., 1998)

Two European countries, Germany and Britain, were selected as countries of origin, and two reasons account for that. Firstly, in economic terms they are powerful economies in Europe. In terms of foreign investment the two countries are considered among the fifth largest foreign direct investors in the world (Dicken, 1999). According to UNCTAD (1999), Britain and Germany are among the countries with the biggest MNCs (this survey only includes non-financial MNCs measured by foreign assets and number of employees). Secondly, these countries present different institutional arrangements (e.g., financial system, corporate governance, and educational and training system) that may have different effects on organisations (see Lane 1992). Therefore, the different nature of the social and institutional arrangements in Germany and Britain make MNC subsidiaries from these origins interesting cases to compare.

2.5.1.2 Selection of the Country of Operations

The selection of the host country had a main criterion, a country with different institutional arrangements to Germany and Britain. Venezuela seemed an interesting case to study. It is a country classified as upper-middle-income, a classification given generally for developing economies (see: www.worldbank.org). Another important aspect of the Venezuelan institutional context is its fragmented nature. It is useful to contrast societies such as

Venezuela, where there is a lack of coordination among the different institutions, with other societies where their institutional arrangements complement and reinforce each other. This fragmentation amongst institutions means that "the rules of the game" are not clearly developed and actors have to learn how to operate around institutions as much as with them. Venezuela is a country with high levels of uncertainty and instability, characterised by a precarious institutional environment where economic variables and regulatory mechanisms are volatile. There is a dearth of studies on the effect of a country with such a distinctive character on MNC subsidiaries whose origins are in contexts with more coordinated institutional arrangements. Finally, there is a lack of research on Venezuela in particular, and South America in general, using the institutional approach. In addition, the access to firms in Venezuela is facilitated for the researcher because of her knowledge of the language, culture and networks with firms from her previous work in the country.

2.5.1.3 Selection of the Industries

The selection of the industries, as was argued above, considered polar types in order to cover the whole spectrum of factors from this level. In order to consider this criterion, these polar types were selected following the typology of Porter (1986), of multidomestic and global industries. MNCs from these industries have different relationships between the corporate offices and the subsidiaries. In the case of multidomestic industries the subsidiaries look to satisfy local markets and they compete on a country basis. The MNC enjoys a competitive advantage from the one-time transfer of know-how to the foreign location. On the other hand, there are global industries in which the competitive position of one firm in one country is significantly affected by its position in other countries, and vice versa (Porter, 1986). MNC subsidiaries in this industry are more dependent on flows of know-how, technology, capital and key personnel from other subsidiaries or corporate offices. As a first step, information about the MNC subsidiaries from Britain and Germany, to select the companies, was requested from the chambers of commerce of the two countries in Venezuela. The idea was to search for potential matches of German and British MNC subsidiaries in the same industry. Another selection criterion was to choose subsidiaries with at least three years of operation in the country. It was important to look at local units with experience of operating in the country to study the effect of the host country on the presence of control mechanisms in the MNC subsidiaries. As a result and due to the nature of the criteria for selecting the cases, there were not many options. The potential matches were in the oil services and business software sectors, and the pharmaceutical industry.

The oil service sector is considered multidomestic because of the nature of its operations. Firms operating in the sector, frequently, offer their services to governments through concessions, or they are contracted by national oil organisations to carry out specific activities in the areas of exploration and production. As a result, they have to respond to demands of the local clients, their operations are aimed to satisfy local markets, and they compete locally to obtain concessions and contracts from governments and national oil companies.

By contrast, the business software sector and the pharmaceutical industry have a more global nature. They are dependent on products and services developed in their Rand D (research and development) centres, they are more standardised and require little adaptation, which in turn makes them less reliant on the local environment. The specific characteristics of the sectors that MNC subsidiaries belong to are explained in Chapter 4.

2.5.1.4 Selection of the MNC subsidiaries

After the identification of the potential matches according to country of origin and sector of operations, the contact with the MNC subsidiaries was initiated. At this stage, an important condition was to choose the ones which assured the greatest chance of access.

Preliminary contacts with different MNC subsidiaries such as Siemens de Venezuela, Bayer de Venezuela, and Aventis, were carried out with negative results in the first two cases. In the pharmaceutical sector some interviews were carried out in the British MNC: Glaxo-Welcome, and in the Franco-German MNC: AVENTIS. However, further access to the two subsidiaries was not allowed. Attempts in the business software sector were more successful in gaining access to two MNC subsidiaries: SAP subsidiary for the Andean region and the Caribbean, and Baan Venezuela, a distributor of Baan. The latter MNC has a Dutch origin but was acquired by a British conglomerate before the time of the research. Despite its character as distributor, Baan Venezuela works very closely with the British MNC because of the nature of the sector, supporting this selection of Baan Venezuela. The selection of this case, as discussed in Chapter 6, is useful for two reasons. Firstly, it supports the analysis of the institutional legacy of the MNC and its effect on the operations of the subsidiary. Second, it sheds some light on the influence of the context of operations in the changes of the subsidiary. The two local units operated in the technology industry, and are examples of a global industry. The characteristics of this industry are explained in detail in Chapter 4.

Access to a British oil service subsidiary, LASMO Venezuela, was obtained. and was a possibility to obtain access to a German oil MNC subsidiary; Preussag Energie Venezuela. These two subsidiaries are representative of the multidomestic industry, the other type of industry under research. The main characteristics of the cases are presented in Table 2.2.

Table 2.2 Description of the Case Studies of the Research

Multinational	SAP AG	Baan	Preussag Energie	LASMO
Subsidiary	SAP for the Andean Region and the Caribbean	Baan Venezuela	Preussag Energie Venezuela	Lasmo Venezuela
Country of Origin	Germany	Britain	Germany	Britain
Industry	Global	Global	Multidomestic	Multidomestic
Date of subsidiary establishment	1996	1995	1998	1997
Employees in subsidiary	160	46	280	279

Baan was not a "pure case" in its origins. Initially, the MNC was founded in The Netherlands and was acquired by a British conglomerate. However, the criteria of the sample design with comparisons across countries and industries, and the limitations in terms of potential cases, made Baan a suitable case. It allowed a comparison across country and the comparison across industries, which was another important criterion of the sample design.

2.5.2 Fieldwork: Collecting the Data

It was decided that semi-structured interviews and secondary data were to be the two main methods of collecting data for this research. Semi-structured interviews were one of the most suitable methods, as the research is looking for the underlying forces that intervene in the presence of control mechanisms through the study of different factors that interrelate, such as country of origin, industry and country of operations. As secondary data, information was collected on sectors of operations and industry, MNCs' annual reports, Internet MNCs' corporate pages and newspaper-documentary sources. This combination between primary and secondary data helped to enhance, triangulate, and validate information from the interviews. Eisenhardt (1989) highlights the fact that theory-building from case study research typically combines multiple data collection methods. Yin (1994) has also pointed out that a major strength of the data collection in case studies is the opportunity to use data from diverse sources, which helps to avoid potential problems of construct validity. To have multiple sources of evidence provides different measures of the same phenomenon.

The design of questions for the semi-structured interviews considered constructs from the literature. Table 2.3 presents the main topics covered in the interviews. It is worth noting that all the topics presented in Table 2.3 were not covered in the initial stages of the data collection: some of them were added as result of the iterative process of analysis of the initial data (e.g., the category of changes over time of the activities, responsibilities, and control mechanisms in the subsidiary).

Table 2.3 Topics covered in the interviews

Section	Topics covered
Background of the Interviewees	• Education • Position in the firm • Previous position in other firms
Subsidiary:	
1. Position and responsibilities of the interviewee	• Level of centralisation/decentralisation of activities to the subsidiary
2. Presence of control mechanisms	• Identification of different devices to control operations in the subsidiary (e.g., human resources policies and practices, and expatriate managers)
3. Subsidiary size, main activities and evolution	• Subsidiary typology
4. Relationship of the subsidiary with other units and corporate offices, MNC strategy for the region, evolution of the MNC	• Type of MNC
5. Change over time of the activities, responsibilities and control mechanisms in the subsidiary	• Identification of the forces that intervene in the presence of control devices
6. Product characteristics	• Nature of the industry
Host-Country Effect:	• Education and Training System • Effect of the Venezuelan environment (e.g., state, financial system, economy) in the operations of the subsidiary • Adaptation of the MNC subsidiary to the local context

Different questions were developed to cover these topics and some of them were changed or were added to the initial analysis, permitting more accurate questions to facilitate the understanding of many subtle processes. In many cases some interviewees were interviewed more than once to clarify information. Table 2.4 shows the interviewees' positions, together with the number of interviews carried out in each MNC subsidiary and with experts on the Venezuelan context. Fieldwork was conducted in different stages: from the autumn of 2000 until the summer of 2002, 66 interviews in total.

Table 2.4 Distribution and Number of Interviews

Interviewee Position	Number	Interviewee Position	Number
SAP for the Andean Region and the Caribbean		**Baan Venezuela**	
Venezuelan HR manager (local)	1	Customer Care Director (local)	1
Venezuelan and Caribbean Alliance Manager (local)	1	Administration and HR Director (local)	1
Business Development Manager (local)	1	Sales and Marketing Director (local)	1
Support Consultant (local)	1	Technology Manager (local)	1
Sales Manager for oil and gas sector (local)	1	Consultant Department Manager (local)	1
Andean New Initiatives and marketing manager (local)	1	Technical Support Manager (local)	1
Andean HR manager (local)	2	Indirect Sales Director for the Latin America Region (expatriate)	2
Consultancy Manager (local)	1	European Sales Manager (expatriate)	1
Indirect sales manager (local)	1	**Total**	**9**
Andean Finance Director (local)	1		
Total	**11**		
Preussag Energie Venezuela		**LASMO Venezuela**	
Operations Vice-president (expatriate)	1	Head of Planning and Reporting (expatriate)	1
Administration Vice-president (expatriate)	1	Senior Exploration Geologist (expatriate)	1
Finance and accounting manager (local)	1	Field Development Planning Manager (expatriate)	1

Standardization leader and special projects (expatriate)	1	Legal Manager (expatriate)	1
Administration manager (local)	1	Senior Economist (expatriate)	2
Reservoir Engineering supervisor (local)	1	Commercial and New Business Manager (local)	1
Petroleum Development Manager (expatriate)	1	Oilfield Engineering (expatriate)	1
Planning and Controlling Manager (expatriate)	1	HHRR and Administrator Manager (local)	1
Security Manager (local)	1	Senior Economist (local)	1
HHRR supervisor (local)	1	Ex Finance Director (head quarters) (expatriate)	1
IT Supervisor (local)	1	Junior Economist (local)	1
Community Advisor (local)	1	Former HR Manager (expatriate)	1
Geologist (expatriate)	1	Senior Exploration Geologist (local)	1
Former gathering project manager (expatriate)	1	**Total Interviews**	**14**
Internal Controller (expatriate)	1		
Total	**15**	**Experts on Venezuelan Institutions**	**Number**
Glaxo-Wellcome	**Number**	Director of the Venezuelan-German Chamber of Commerce (expatriate)	2
Finance Director (local)	1	Director of the Venezuelan-British Chamber of Commerce (expatriate)	1
Human Resources Director (local)	1	General Manager of the Venezuelan- British Chamber of Commerce- (expatriate)	1
Total	**2**	Executive Director of the Venezuelan office for the promotion of the foreign investment (CONAPRI)	1
Aventis	**Number**	Expert on the education and training system in Venezuela	1
Commercial Controlling Manager (expatriate)	1	Expert on the Venezuelan financial system	1
Finance Control Area Supervisor (local)	1	Associate Managing Director of Korn/Ferry International	2
Finance Director (expatriate)	1	**Total**	**9**
HR Supervisor (local)	1	Expert on ERP systems	**2**
Total	**4**	**Total number of interviews**	**66**

The majority of the interviewees in the case of the MNC subsidiaries occupied managerial positions. The rationale of this choice was that managers were the executors of control mechanisms in the subsidiaries and could elucidate the different reasons for implementing them. The schedule for the interviews was organised by reviewing first the organisational chart of the subsidiary and then by selecting key positions for obtaining data for the study: usually, heads of departments and top management (general managers, vice-presidents and directors). However, it was not always possible to interview the members of the latter group. In addition, according to the position of the interviewee, a set of questions was selected to obtain a more accurate picture of the activities and presence of control mechanisms in each area. All the interviews were recorded, some in English (interviews with expatriate managers) and others in Spanish. They lasted on average one and a half hours.

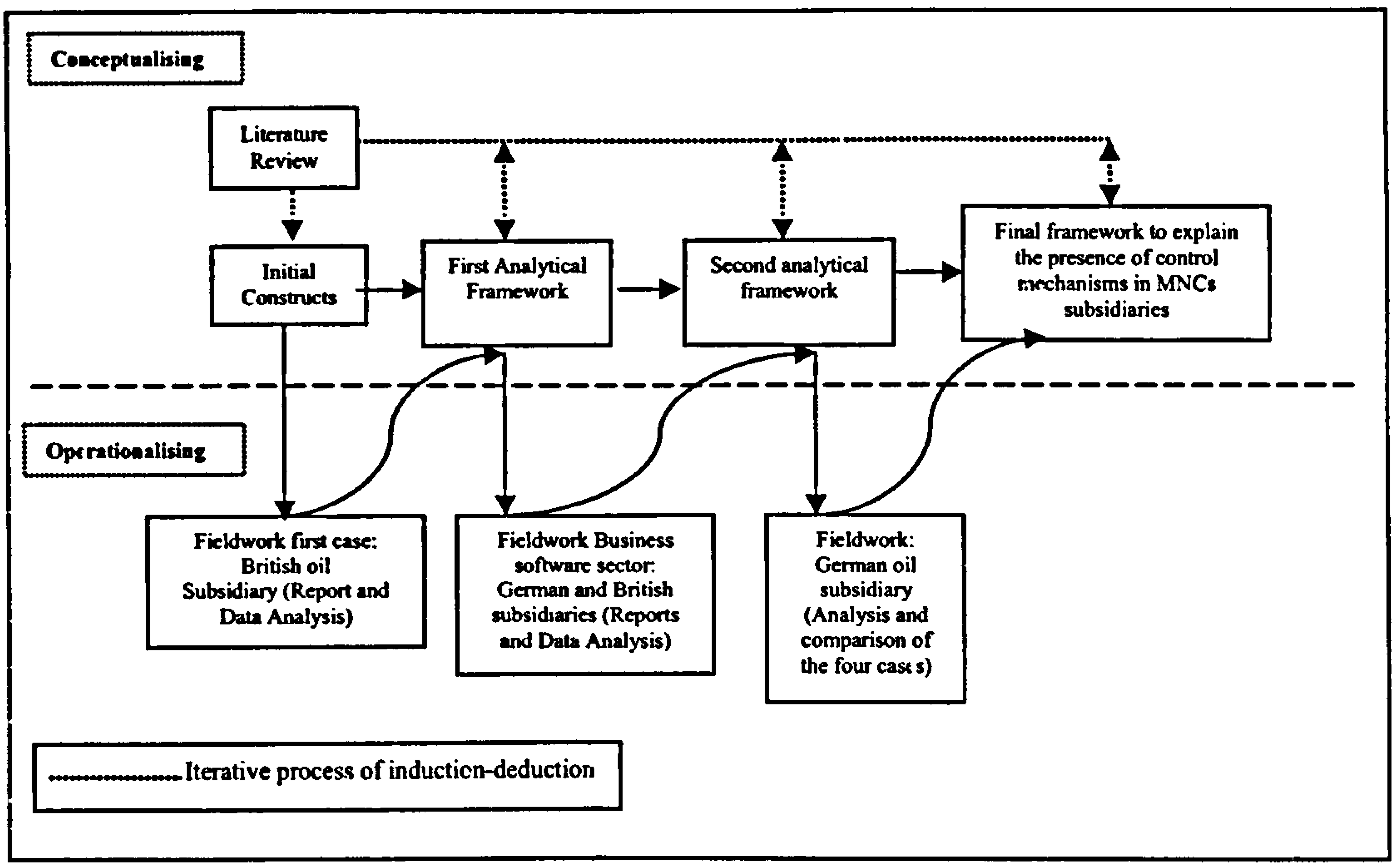
2.5.3 Data Analysis

The analysis of the data in the research involved several steps, and different tools were used to aid the analysis of it. Figure 2.2 depicts the iterative model used to develop the theoretical framework of the research. An iterative process of deduction and induction, linking the literature with the research findings, ended in the final theoretical framework presented in Chapter 1.

The initial literature review helped to develop the initial constructs which better facilitated the design of the interview questions. They were used to collect the data from the first case: the British oil subsidiary. The analysis of this data started with the writing-up of a report on the case. According to Eisenhardt

(1989) and Miles and Huberman (1994), although this process is simply descriptive, it is central to the generation of insights.

Figure 2.2 The Iterative process of Deductive and Inductive Analysis in Case Study Research



A first analytical framework was developed from the analysis of the British oil subsidiary case and the comparison of the findings with the current literature. Using replication logic (Yin, 1994), this preliminary framework was used to carry out the interviews in the business software subsidiaries. A second report with the comparison of the two cases was written, with a less descriptive and more analytic approach. However, new insights emerged from the data of the last two cases that had to be further explored in the existing literature. The preliminary analytical framework was modified to incorporate the new findings. The collection of the data from the last case, the German oil subsidiary, followed again the replication logic, looking for information according to the analytical framework developed. Finally, the comparison of the four cases across countries and industries was carried out, with the result of the final framework of the research. This helped to write the chapters of the thesis that present the cases, Chapters 5 and 6, according to the different features that explained the presence of control mechanisms in the subsidiary. This iterative process in the analysis helped to avoid the risk of constructing case studies only from a descriptive perspective, suffering from a lack of connection with theoretical concepts (Yin, 1994).

Three activities were undertaken to carry out the analysis: data reduction, data display, and conclusion drawing/verification (Miles and Huberman, 1994). Data reduction is the process of selecting, simplifying and transforming the data from written-up field notes and interview transcriptions. Data reduction techniques used in this research can be listed as follows:

- Contact Summary sheet: A summary of the main information on the contacts (people interviewed) in each subsidiary.
- Codes: labels assigned to data collected during the research. This helps to reflect on the data and organise it.
- Reflective remarks: raw field notes (researchers' thoughts about interviewees, doubts about the quality of information, new insights and causal relationships)
- Memos: they are conceptual elaborations that come from the analysis of the data. Their aim to tie together different pieces of data in clusters, and also they define causal relationships.

Finally, ATLAS/ti, a software to analyse qualitative data, was used. It helped to define codes and clusters, and classified information according to them. This software is effective with large amounts of qualitative data, allowing coding and re-coding.

The data display was the activity of organising, compressing and assembling information that permitted conclusion-drawing. Matrices and graphs were the main data display tools in the research. A case-ordered descriptive matrix, for instance, was elaborated with the different control mechanisms in each subsidiary, grouped according to the typology used and listed by departments and looking at similarities and differences among the case studies. In addition, graphs were drawn to determine causal or explanatory relationships, which might explain the presence of control mechanisms in the MNC subsidiaries.

The conclusion drawing and verification underlined regularities, patterns and explanations, and causal flows. The preliminary frameworks were the result of conclusions drawing, and they were adjusted using this process of data collection, data reduction, data display and conclusions verification. The suggestion of Miles and Huberman (1994) on noting relations among the constructs and building a logical chain of evidence was followed. The verification process was carried out by checking field notes and interview transcriptions, and in some cases, going back to the informants to clarify information.

2.6 Conclusions

The different activities of the research design, the selection of the cases, the collection of the data and its analysis, were developed to obtain external and internal validity, and reliability. The external validity was achieved through the development of theory in the research design with the definition of theoretical constructs, which were used to develop the initial interview questions. The replication logic followed in the selection of the cases was another tactic suggested by Yin (1994) to obtain external validity. Activities such as the use of case study protocols are tools to strength the reliability of the research and the different activities in the data analysis, such as data reduction, data display and conclusions drawing/verification make more robust the internal validity of the research.

The iterative process of induction and deduction followed in this research allowed a comparison of the emergent concepts and causal relationships with the existing literature, which either supports the research findings or, by contrast, contradicts them. As Eisenhardt (1989) states, this strategy increases the confidence in the results (internal validity) and reduces the risk of having findings which are idiosyncratic to the specific cases.

One of the main critiques of qualitative research is the difficulty of generalisation from case study findings to a population or universe. It is important to highlight the fact that the generalisation from case study research is an "analytic generalisation" and not a statistical generalisation, in which theory is developed from the analysis of one case and other cases are analysed to support the same theory or to modify it according to the findings from the analysis of the rest of the cases (Yin, 1994). The development of a framework to understand the presence of control mechanisms in MNC subsidiaries provides a systemic explanation that can be used in further research to analyse the presence of these devices. However, it is important to highlight the fact that the findings of this research are not universal; as was stated in the philosophical position of this research, they represent explanations of reality and are subject to replication in order to support the causal relationships explained in the framework.

Chapter 3: The Influence of the Country of Origin and the Country of Operation on MNC Subsidiaries

3.1. Introduction

This chapter discusses the effect of different social institutions on the operations of firms. It takes as a basic ground that firms are built out of specific institutional contexts that shape their structures, practices and procedures. The same premise is applied in studying their internationalisation. MNCs carry with them a legacy that shapes their strategies and structures, which is the result of their social embeddedness in a specific institutional context (Morgan, 2001). Chapter 1, in the presentation of the analytical framework of the thesis, highlighted the importance of studying the home-country institutions to understand the implementations of control mechanisms in MNCs. This chapter fulfils this aim analysing the institutions from the country of origin of the MNCs. In addition, the chapter also sheds some light on the nature of the institutions of the country of operations. As was also discussed in Chapter 1, the subsidiary development is linked to the opportunities and constraints deriving from its country of operations. These can be understood through the study of the institutions and economic arrangements of this country. This chapter also fulfils this second aim.

This chapter is organised as follows. First, it discusses the rationale of having a country level of analysis to understand the presence of control mechanisms in MNC subsidiaries. Second, the debates on the influence of the country of origin in MNCs are presented. Third, the debates on the influence of the country of operation on MNC subsidiaries are also discussed. The following section highlights the main institutions of Germany and Britain and how they have influenced the shape of local firms and MNCs. In this section, ideal types of control mechanisms according to the country of origin of the MNCs are also developed. The fifth section describes the main institutions in Venezuela and how they have affected the evolution of local firms. Finally, the main conclusions of the chapter are presented.

3.2 Country Level of Analysis

A topic of much recent debate concerning the study of MNCs is the extent to which MNCs reflect features of their country of origin. The globalisation enthusiasts and those favouring the model of stateless organisation argue that firms are becoming more alike, and there is no identification with a particular national culture or set of government industrial policies (Ohmae, 1999). Firms are converging towards a model of stateless organisation that has developed to satisfy universal needs and markets. The development of communications, the high levels of capital flows among countries, the diffusion of technologies, and the high mobility of managers are some of the reasons which account for this.

A counterpart to this argument is the position that, despite the pressures towards convergence, firms remain highly distinctive. This is because organisations are embedded in unique institutional arrangements that shape their organisational actions. Clark and Mueller (1996) emphasize that "firms are so embedded, constrained and encultured by their national homes that the room for corporate agency and its zones of manoeuvre could be, and perhaps is, rather small". The same proposition is applied to MNCs: some authors argue that they are so embedded in the national institutions of their country of origin, that these still shape corporate decisions (Morgan, 2001; Whitley, 2001; Doremus et al., 1998; Pauly and Reich, 1997).

Doremus et al. (1998) highlight the fact that national histories have an impact on the internal structure of the MNC and the development of its core competencies. They make clear the differentiation in the way that MNCs from different countries organise and develop competitive advantages. Authors such as Porter (1990) claim that national features are crucial factors to the achievement of international standing of firms, and that different features from their national context facilitate the development of competitive advantages of firms and their internationalisation process. Dunning (1993) explains the internationalisation of firms through a set of tangible and intangible factors, some of which are associated with the conditions and institutions of the country of origin of the firm. Kogut (1993) argues that the country of origin is a factor to be included in the study of the behaviour of MNCs, because of its explanatory power. Dicken (2003) states that there are distinctive institutional arrangements and practices that produce particular kinds of MNCs.

Context matters as a factor that influences the operations of MNCs. The analysis of MNCs has to consider the influence of the country of origin of the firm as a level of analysis. However, when the study of MNCs is focused on subsidiaries as the unit of analysis, another context that it is important to incorporate into any study is the country of operations. In recent years, there is an increasing recognition of the fact that the country of origin effect on MNC subsidiaries can be mediated by the characteristics of the country of operations (Geppert et al., 2003; Dicken, 2003; Quintanilla, 1998). Country of origin and country of operations are referred to in this chapter as the kinds of institutional contexts that are associated with distinctive patterns of economic organisation that affect the structures and processes of firms.

During the '80s and '90s a new approach focused on the study of social systems of production emerged. A basic premise of this research stream is the assumption that the behaviour of firms is shaped by the economic and institutional context in which they are embedded. According to this, the fact that organisations are shaped by their institutional context means that organisations have different capacities and develop different capabilities depending on the context to which they belong. This is reflected in the existence of different social systems of production that are influenced by a set of collective institutions at regional, sectoral, or national levels (Hall and

Soskice, 2001). There are a variety of approaches in the institutional stream that look at this aspect. Their focus has been mainly in three institutions: financial system, the state, and the education and training system (Hall and Soskice, 2001; Whitley, 1999; Whitley, 1992a; Lane, 1992; Sorge and Maurice, 1990).

Whitley (1999; 1992a) incorporates these elements together and develops patterns of economic organisation called business systems (BSs). He defines a BS as "distinctive patterns of economic organization that vary in their degree and mode of authoritative coordination of economic activities, and in the organisation of, and interconnections between, owners, managers, experts, and other employees". These BSs are frameworks to study different economic arrangements that affect firms' structures and practices in different countries. An underlying assumption of this institutional stream of thought is that the economic coordinating mechanisms, which are shaped by the institutional arrangements of the country, place constraints on the definition of needs, preferences, and the choices of economic actors (Hollingsworth and Boyer R. 1998).

The varieties of capitalism is another approach to analyse the behaviour of firms that is rooted in institutionalism and incorporates these three elements as well (Hall and Soskice, 2001). It also focuses on the study of the effect of institutions on the behaviour of economic actors. The approach considers the firm as the centre of the analysis and assumes an actor-centred position, in which multiple actors seek to fulfil their own interests in a strategic interaction with others. According to the different arrangements that firms implement to resolve their coordination problems, the framework presents two types of political economies: liberal market economies and coordinated market economies.

A liberal market economy is characterised by coordination of the economy activity through hierarchies and competitive market arrangements (e.g., the US). By contrast, in the coordinated market economy, firms depend more heavily on non-market relationships to coordinate activities with the other economic actors and to develop their core competencies (e.g., Germany) (Hall and Soskice, 2001). Although these classifications are very useful to typify types of economic arrangements, they are ideal types and do not consider the possibility of change and evolution of the institutional environment. Institutions are exposed to change and this factor should be included in the analysis of the effect of institutions on the behaviour of firms.

According to the institutionalist perspective, there is considerable influence from institutions on the behaviour adopted by firms. They are sources of explanation for the structure, practices, and capabilities developed by firms that belong to a particular institutional context. Although the international character of their operations recognizes MNCs, at least in their initial origins they are linked to a specific institutional context which has shaped their activities. The next section reviews the current debate over the effect of the country of origin on MNCs.

3.3 The Influence of the Country of Origin on the Operations of MNCs

Within the institutionalist literature, it has become commonplace to differentiate market economies according to the nature of institutions. Significant variations in the organisation of firms and markets across Europe have been highlighted (Hall and Soskice, 2001; Whitley, 1999; Doremus et al., 1998; Lane, 1992; Whitley, 1992b). These variations across countries are reflected in the nature of firms linked to a particular context, which is also the case of MNCs.

There is a discussion over to what degree MNCs continue to be embedded in their country of origin in the management of their operations. This discussion implies two extreme positions. On one hand, there is the position that MNCs organise their operations abroad according to the home base mode. Therefore, the MNC as a distinct organisational form does not exist and they have to be seen as national firms with international operations (Hu, 1992). On the other extreme, there is the position that argues the idea that MNCs are organisational forms in which their competitive strategy is not shaped by national origins. Their capabilities are derived from assets that can be developed anywhere in the world and can be combined in globally optimal manners according to circumstances (Lane, 1998). The rationality of the decisions in MNCs that make them being stateless firms is subject to debate according to some authors, who emphasise the role of the strategic interaction and political issues among multiple actors and levels in the firm, which very frequently affect the decisions taken by MNCs (for more detail see Kristensen and Zeitlin, 2005).

Hu's (1992) main argument is that firms remain rooted in their origins. MNCs are organisational forms in which corporate offices that are embedded in the parent country exert control over the subsidiaries. In addition, the largest bulk of the workforce is concentrated there. By contrast, the subsidiaries have distinctive characteristics that are shaped by host institutions, practices and values. According to his perspective there are clear difficulties for the MNCs to become global corporations, in other words, they remain local firms with international operations.

Whitley (1998) has a similar view of the impact of internationalisation on the nature and behaviour of firms. He highlights the fact that the conditions required for significant change are so rigorous and numerous that it is unlikely that changes in the characteristics and strategies of firms can occur. The fact that MNCs have to deal with different environments is going to create differentiation in terms of structures and procedures, but it is unlikely that the core characteristics of the firm will change because of this.

Other authors such as a Ferner (1997) take a more middle ground position. He highlights the fact that the behaviour of MNCs in the country of operation can take different forms. There are two alternatives: one which is the complete transfer of the patterns from the country of origin to the subsidiary, and the other which is the full adoption of local practices from the subsidiary side. However, he stresses that there are difficulties to achieve either of these. It is unlikely that an MNC subsidiary is fully integrated or fully localised instead, the local unit can become a hybrid model in which host country norms mediate the influence of the parent country. This hybrid model shows a distinctive influence from home country institutions on the design of strategy and in some organisational practices in the MNC. However, the firm will have another set of organisational practices, which may respond to other effects such as globalisation, organisation, or host country effects. The MNC adopts a hybrid form because of this combination of practices from different origins. Lane (1998) defends a similar argument, arguing that MNCs are becoming hybrid firms. There is a tendency among MNCs to become transnational companies, which are decentralised in terms of assets, activities and functions. However, the path to become this type of MNC is shaped by specific national features in each country. There is a process of hybridisation among firms, which eventually leads to change in their identity but not its complete abandonment.

Whitley (2005) has stated that there are different degrees of hybridisation in MNCs. The adoption of practices in MNCs, which may not accord with the traditional choices of local firms from the country of origin, is subjected to certain conditions. For instance, the implementation of practices in MNC subsidiaries because they have pressures from their context of operations might be easier for companies belonging to arm-length environments. However, to integrate these practices into the rest of the MNC and become a hybrid organisation is unlikely to occur because there are no pressures from other contexts (e.g., home or international environments) to enable this. In addition, MNCs that are linked to certain institutional environments with strong institutions that support each other (e.g., Germany and Japan) can have constraints from the local context to develop certain organisational capabilities at home. In this case, they might adopt new organisational practices in the MNC subsidiaries that facilitate the development of new capabilities within the firm but at subsidiary level. In this case the hybridisation will be only at subsidiary level.

Another argument related to the degree of hybridisation of firms has been developed by Lane (2001; 2000; 1998; 1992). There is the possibility of managerial strategic choice in the adoption of new business practices in MNCs, despite the constraints imposed by the home BS. There are limitations to the free transferability of a "business recipe" from one national context to another. Although, there is adaptation from the BS in response to challenges from the global economy system, they occur under the previous frame of the BS, which shapes its absorption. Therefore, the possibilities of radical organisational change in MNCs are rare. The key for the adoption of a hybrid form in MNCs relies on the level of integration of their operations. MNC subsidiaries with high levels of autonomy and resources become embedded in the host countries. A learning process occurs and there is the adoption of new structures and practices, and the development of new capabilities, which make the MNC subsidiary to take a hybrid form. If the MNC corporate offices and the subsidiaries are highly integrated and the BS allows the absorption of the practice, there is a process of reverse diffusion (Edwards, 1998). The new practices and capabilities will change the MNC structure and processes creating a strong organisational effect.

The levels of hybridisation in MNCs, according to other authors such as Quintanilla and Ferner (2003) are also explained by the characteristics of the sector of operations, which can act as a mediator of the influence of the parent country on MNCs (Whitley et al., 2003; Ferner and Quintanilla, 2002). The addition of this level generates further complexity in the study of this type of firms. According to Quintanilla and Ferner (2003) the study of this organisations should put less emphasis on looking for great tendencies and to concentrate on how complex processes work in particular situations. Elements of convergence (in some areas), coexist with features of divergence (in others). Sectoral particularities account for one of the explanations for the differences on the levels of hybridisation found in MNCs from the same country. A basic premise of this approach is the assumption of a distinctive effect from the parent country of the MNC (e.g., the "Americanness" of US MNCs and the "Germanness" of German MNCs); however, it has to interact with features of the sector that pull in a certain direction in the adoption of business practices within MNCs. This perspective assumes a less static nature of a BS; by contrast, they are subject to change and evolution. This more dynamic nature of the BS opens room for the adoption of novel organisational practices in MNCs, which might be different from domestic ones (Edwards and Ferner, 2002).

Finally, the levels of hybridisation may vary in the MNC. The need of the MNC subsidiary to localise and adapt to the local context influences the incorporation of local practices into the local unit. However, this integration in the firm may be at two levels, local or global. If the MNC has a multinational form with little coordination among its local units, with decentralisation of activities and responsibilities, it would be more difficult to integrate the practice to the whole organisation. The hybridisation would be local rather than global and the identity of the firm will remain the same. By contrast, if the organisational form of the MNC allows more coordination and integration among local units the chance to incorporate the new organisational practice of the subsidiary to the whole firm would be larger. In this case, there will be a grater chance to impact the identity of the firm. The hybridisation will have a global rather than local character.

In sum, different perspectives explain the levels of hybridisation in MNCs. The adoption of novel organisational practices, which are detached from the country of origin of the MNC, are explained by different factors (e.g., sector, level of integration of the MNC, or technology). However, there has been little emphasis on how the country of operations of the MNC subsidiary influences the adoption of novel practices, and the development of transferable capabilities, in the local unit. The next section reviews the different positions taken to explain the effect of the country of operations in MNC subsidiaries.

3.4 The Influence of the Country of Operations on MNC Subsidiaries

The study of MNCs has moved a step further with the addition of the effect of the country of operations on the MNC subsidiaries. However, this is an area that has been rarely researched, and posits a different view of the traditional hierarchical relationship among corporate offices and subsidiaries. In this new approach, the effect of the context of operations on subsidiary behaviour, is investigated under a different set of assumptions about the subsidiary as an organisational unit. First, it is assumed that the subsidiary is an entity with some level of autonomy from corporate offices, with a more active role in the decisions that might affect its operations. Second, the adoption of new practices, and the integration of capabilities developed at subsidiary level by the rest of the MNC imply that the subsidiary might influence the rest of the MNC. This position is contrary to the long-established view, in which subsidiaries have a more passive role and only respond to a corporate mandate. By contrast, this novel approach supposes that subsidiaries are entities with their own dynamics, are struggling to develop their own identity, and increase their range of power (Quintanilla, 1998).

MNC subsidiaries struggle with opposing demands. On one hand, there are forces from corporate offices that pull for integration. These forces are shaped by features from the country of origin, sector of operations and even the strategic choices of the firm. On the other, the context of operations of the MNC subsidiaries demands localisation, to adapt to a regulatory environment, a set of local institutions and markets. They can become hybrid organisations, which show features that are explained by elements outside of their context of operations such as the nature of the institutions in which they are embedded (Ferner, 1997; Rosenzweig and Nohria, 1994).

The country of operations effect on MNC subsidiaries varies and it creates different levels of hybridisation. For instance, when there is a strong institutional system MNCs have more pressures to comply with it than in a weaker institutional environment (Muller-Carmen et al., 2001).

Whitley (2005) states that the stronger and more complementary are the host economy institutions, the more probable is the adoption of host business practices by the MNC subsidiaries. In this case, the effect from the host country is the dominant one. By contrast, in host environments in which the social institutions are less complementary and act independently, there is more room for subsidiaries to adopt a wider range of business practices. A parent country, organisational and globalisation effects may be dominant ones.

In sum, the country of operations matters and its effect on MNC subsidiaries varies. Strongly regulated institutional regimes, in Ferner's words, or strong and complementary institutions, in Whitley's ones, add more pressures to the subsidiaries to adopt business practices embedded in such contexts. On the other hand, weaker institutional environments or less cohesive and deregulated ones open more opportunities for MNC subsidiaries to adopt different business practices, which are influenced by the country of origin of the MNC or respond to global or organisational effects.

The study of the effect of the country of operations can be not only through its power to mediate the home country effect or other organisational influences in the adoption of business practices in the subsidiary, but also through its effect on the development of capabilities at subsidiary level (Morgan and Whitley, 2003; Morgan et al., 2003; Geppert et al., 2003; Morgan, 2001). Any subsidiary has its own social characteristics associated with the country of operations. The nature of the host BS is so powerful that it provides the conditions to develop capabilities in the subsidiary, which might enhance or not its position within the MNC. In other words, the development of capabilities in the subsidiary, which are highly valuable or scarce in the MNC, is affected by the opportunities and constraints that the context of the country of operations offers to the local site.

The last position on the effect of the country of operations combines different elements, to analyse the development of subsidiaries. The country of operations affects the subsidiary development, as well as other features such as the parent country, and elements internal to the subsidiaries (Belanguer et al., 2003; Birkinshaw and Hood, 1998). There is a set of forces from the country of origin of the MNC, such as its origins within a particular BS, the characteristics of the local markets, the type of technology that the organisation uses, its corporate culture, and strategies that shape the local unit. However, the country of operations and certain institutions within it is another shaper of the subsidiary. Organisational changes in the MNC subsidiaries may be led by the subsidiary; however, the decisions of the subsidiary are framed by corporate policies and institutional arrangements from the parent and host countries.

This review of the different positions on the effect of the country of origin and the country of operation highlights some points which are important to mention. Firstly, institutional contexts are a valuable source to explain the behaviour of MNCs. There is a link between the origins of MNCs and how the economic institutions have shaped the path taken by them. Moreover, these institutional arrangements also affect the internationalisation process of the firm and the transfer of business practices to its subsidiaries. However, this effect from the country of origin is mediated by the characteristics of the context in which MNC subsidiaries operate. The characteristics of the institutional arrangements in the country of operation play an active role to shape the adoption of practices, on one hand, and the development of capabilities in the subsidiary, on the other. In the same order of ideas, all these activities are intimately related to the nature of the control mechanisms implemented in MNC subsidiaries.

Secondly, there are variations in the power of the country of operations to affect the operations of subsidiaries. Some of them exert a larger influence than others. For instance, when the institutions are more complementary or there is a highly regulated environment, and the BS acts more cohesively, the influence of the host context is greater. Thirdly, the positions adopted to explain what features influence the operations of the subsidiary range from a deterministic view, where the context is the main influence on the operations of the subsidiary, to another which combines the deterministic view with a more voluntaristic position of the managers of the subsidiary that gives them the possibility to choose among a set of alternatives that shape the subsidiary development. However, the number of alternatives is restricted by the conditions of the country of operations, which supports some choices more than others.

Finally, causal relationships are clearer in the case of the effect of the country of origin in the MNCs, but not in the case of the country of operations. More research in this area is needed, particularly in contexts in which the institutions are not complementary and they do not work as a coherent system. The next section, as a first step to understand the effect of the country of operations in MNC subsidiaries, discusses two divergent institutional arrangements, British and German, on MNCs from these origins. After this, the potential effect of the country of operation in MNC subsidiaries is discussed with the analysis of Venezuela as a country of operations.

3.5 Country of origin effect on German and British MNCs

This section presents the main institutions of the countries of origin of the MNCs chosen in the research: Germany and Britain. As has been argued, there is a strong connection between the shape adopted by firms and the nature of the institutions. This section highlights the link between the institutions of the two countries and the practices, structure and international strategies developed by firms. In addition, it presents ideal types of control mechanisms according to the country of origin of the MNCs. The main institutions analysed are the state, the financial and the education and training systems, which are considered to be crucial institutions in shaping the characteristics of firms (Whitley, 1999; 1992a; Lane, 1992).

3.5.1 Main Features of the German Model and their Effect on Local Firms

Germany has been characterised as a coordinated market economy in which firms depend on non-market relationships to coordinate their activities and develop their capabilities. This form of coordination frequently involves extensive relational or incomplete contracting. Control activities are carried out through networks and the exchange of information within them, and there is more reliance on collaborative relationships rather than competitive ones to build the competencies of the firm. Firms interact strategically, and the result of this interaction depends on the presence of supportive institutions (Hall and Soskice, 2001). The model in Germany is characterised by strong institutions, which are complementary, in the sense that the presence of one institution increases the efficiency of others.

Other authors, such as Whitley (2001), refer to the German institutional context as a collaborative business environment. This type of business environment has a number of important institutions that together lock key actors into each other's actions, encouraging cooperation among them by limiting exit opportunities. The state plays an important role in this type of business system.

In the case of Germany, it is not directly involved in the coordination of economic development, but encourages private associations to coordinate activities, and supports a strong public training system in collaboration with employers and unions. Germany is also recognised by its highly regulated nature and strong institutions. In addition, the regulated environment has developed a rational-legal bureaucratic pattern of administration, which has influenced the management of firms through bureaucratic coordination (Lane, 1997).

There are institutions with distinctive characteristics in Germany, which have shaped the nature of indigenous firms. The financial system is one of them. Zysman (1983) distinguishes two types of financial systems, each of them are affecting in a different way the relationships between banks, industries and firms. The first type is a capital-market based system, in which the resources are allocated in competitive markets based on prices. Markets are large and liquid, which through a commodity process trades and prices resources. Most investors in this type of system deal with portfolios of shares, which can be traded in secondary and tertiary markets. The financial systems of the US and Britain, for instance, are examples of a capital-market based system.

The second type is a credit-based financial system, which on one hand can be subjected to strong intervention from the government or state agencies to administer capital or on the other be dominated by financial institutions. This type, typically, has weak and illiquid capital markets. The state or banks allocate capital to particular sectors or activities, because of the concentration of capital in a few hands (e.g., universal banks), or the regulation from the state (e.g., control of interest rate) creates a situation in which the demand for capital exceeds the supply of it.

Germany is a case of a credit-based financial system dominated by financial institutions. It has been based, traditionally, on bank credit to support the growth of firms, affecting the development of stock markets in the country (Lane, 1992). Banks play an important role in supporting industrial development in the country through their participation in floating companies, providing long-term credits, being shareholders with an important participation, managing the shares of others and occupying positions on the supervisory boards of companies. The implications for German firms of having funding from this sort of shareholder is that it supports long-term investment and means the acceptance of low dividends, making hostile takeovers difficult as means to increase the return of shareholders (Jürgens et al., 2000; Scott, 1997;Lane, 1992). Therefore, the investment of firms is more strategic because they do not face competitive pressures to maximise returns in the short term (Vitols, 2003; Ferner et al., 2001; Vitols et al., 1997; Streeck, 1997). In addition, monitoring activities in firms are carried out through networks, which are initiated between managers and technical personnel inside the firms, and continue with personnel in other firms. Other types of economic actors (e.g., unions, suppliers and clients) are closely involved with companies: this fact forces the latter to share information with the former regarding its performance, which in turn is another mechanism to monitor operations (Hall and Soskice, 2001).

Company growth financed by bank credit has not diminished the family-owned nature of German firms. Family-owned companies are a majority among the small and medium enterprises, and among very large corporations too. The nature of the financial system and the greater protection against hostile takeover afforded by this are some of the reasons for this presence (Ferner et al., 2001; Lane, 1992). There is a dual board structure in firms, with supervisory and executive boards. The existence of two different boards has implications for top managers within the firms. The supervisory board traditionally acts as a filter for the demands of the shareholders, and the chief executive and the rest of the management team do not generally face the same pressures as their Anglo-Saxon counterparts. However, this feature of the German corporate governance has changed in recent last years, with the management team facing more responsibility for the performance of the company. The European Union has developed standards to manage the operations of firms in the region. For instance, the European Commission has recommended a "cooling-off period" of five years before an executive of a European firm moves up and joins its supervisory board. This is contrary to promotion practices in Germany in which former chief executives move straight up to supervisory boards (The Economist, 2004).

The state is another institution that influences the development of the German firms. It has limited capacity of direct intervention in the economy, because it has fragmented sovereignty and there are constitutional limitations on discretionary government action (Wood, 2001). The European Central Bank dictates economic policies for the European region looking for monetary stability without intervention from the European states. The federal cartel office is responsible for competition policy, and industrial policy is on the hands of the *Länder*. The decentralisation of government functions to autonomous institutions and the constitutional limitations on government interventionism has kept the federal government to intervene much directly. It is more concerned on creating a stable environment for business (Schmidt, 2002). The state has concentrated its efforts on providing infrastructural supports such as for research and development activities, promoting social cohesion through a generous welfare system, and equitable living conditions across the country through a redistributive system of revenue sharing across the *Länder* (Streeck, 1997).

Firms show less opportunistic behaviour because of the established rules of the competitive game, which also permits strategic decisions to be made with reasonable expectations on the calculation of the outcomes from the investment. There is high commitment to a specific product or technology (Whitley, 1999). There are also strong constitutional protections (e.g., the right of unions and employee associations to regulate wages and working conditions without intervention from the government). The result of this type of state is predictability and stability of government policies: the political innovation is relatively minor and the economic agents can develop stable expectations, developing lasting relationships with one or another (Streeck, 1997). The German state fits what Whitley (2005) refers to as an *inclusive corporatist state,* which is interested in actively involving business associations in the economic development and to give them the role of state agencies, which look for predictable and reliable patterns for the achievement of development goals. According to his view, this type of state develops cohesive patterns of labour organisation that encourage firms to work in coordinated ways with them, and with unions and state agencies. Firms regulated by a state with these characteristics have a closer integration of management and labour, and productive tasks, and a more communitarian approach to problem resolution (Lane, 1998).

Another characteristic of the German economy is the extensive use of labour with high industry-specific and firm-specific skills, which requires a training system capable of providing workers with those skills. Industry employer associations and trade unions supervise the training system, and pressure firms to take apprentices and avoid "free-riding" behaviours of the training efforts of others. The skills required by an industry are negotiated, and training protocols are developed according to the needs of each industry and sector. In this way, the system balances the supply and demand for labour. On one hand, it supplies personnel with the skills required by industries and sectors; on the other, it assures that there is a demand for graduates from the training system (Hall and

Soskice, 2001). As the training system shows high levels of technical specialisation, which are aligned with the needs of industrial sectors, the education of German managers is dominated by technical background (e.g., engineering) with specialisation in specific areas (Streeck, 1997; Fox, 1992; Lane, 1992). This technical background of the German managers is reflected in the great emphasis of German firms on technical functions, including a considerable connection between development and production activities (Harzing et al., 2002).

The levels of cohesion and coordination among the institutions of the German business environment have also facilitated the development of long-term employment contracts. The relationship between employers and workers is shaped by distinctive patterns of labour organisation that have allowed firms to engage in continuous discussions with unions and state agencies. Employment and labour relations are organised in ways that encourage cooperation, which is also supported by the long-term nature of the relationship between employers and employees (Whitley, 2005; Vitols et al., 1997).

As is discussed above, German institutions have distinctive effects on local firms. Table 3.1 presents a summary of the main characteristics of the local firms shaped by the nature of the German institutions.

Table 3.1 Main Characteristics of German firms according to the Influence of Social Institutions

Institution	Characteristics of the Firm
Financial System	• Supports the development of specific industries or sectors • A long-term horizon on the nature of the investment of firms • Monitoring activities of firms through personal networks • Close relationship among the firms and unions, suppliers and clients • There is a concentration of family-owned and family-managed enterprises
State	• Reduces opportunistic behaviour of firms, and commitment to specific product, industry or technology • Highly regulated labour environment which shapes the relationships between firms and unions to be largely coordinated and to have a communitarian approach
Education and Training Systems	• Education of German managers has a strong technical background • Enterprises are highly specialised with strong support to the Rand D and production areas • Employees are on long-term employment contracts

There is a cascade effect on how institutions affect some features of German firms and their processes of internationalisation, which is discussed in the next part. As Morgan (2001) has argued, MNCs are built in specific institutional contexts that have moulded the way they internationalise. There are distinctive characteristics of the structure, strategy and practices of firms, which can be explained according to the nature of the social institutions of the place that they belonged to. In the case of Germany, the strong and distinctive features of the German business environment have also affected how firms have moved to operate in the international context.

3.5.1.1 The Internationalisation of German Firms

There are distinctive characteristics of German organisations in their process of internationalisation, which in turn affect the coordination of their activities abroad. The deep domestic embeddedness of the German firms, is argued, has led them to use predominantly the exporting route to internationalisation (Lane, 2001; 1998). The strong reliance of German firms on their home base institutions have made more attractive for German firms to take the export strategy than follow the FDI route. This tendency has changed gradually since the mid-'80s. FDI has increased significantly and the increase has been particularly strong in the '90s (Lane, 1998). The increase in the volume FDI of German firms has taken different forms such as the relocation of basic production facilities and the decentralisation of Rand D activities abroad. In sectoral terms, there is significant investment in the oil industry in the US and the United Kingdom in the second half of the '90s. It has been a decrease of German investment in the manufacturing sector during the same period (from 60 per cent to 33 per cent). The distribution of the investment in this sector is concentrated in the chemical industry (35 per cent) followed by motor vehicles (17 per cent), and metal and mechanical products (14 per cent). The investment in the service sector is concentrated in insurance and business services (77 per cent) (Dicken, 2003).

Whitley (2001) describes German firms as organizations with little experience in managing operations in adversarial, weakly institutionalised environments, and which find it difficult to conduct activities in contexts different from their collaborative business environment. Because of this, the German MNCs limit the size and centrality of their initial FDI and concentrate their business in familiar environments (e.g., Western Europe) which are easy to control, showing signs of late internationalisation compared with their British and US counterparts (Ferner et al., 2001; Lane, 1998). As MNCs, they tend to be closely supervised and integrated into the parent country activities, with a concentration of Rand D activities and workforce in Germany. The corporative nature of the industrial relations in Germany, and the considerable influence of German unions account for the concentration of the workforce in the country (Lane, 1998).

Harzing, Sorge, et al.. (2002) stress that German MNCs perform on the basis of an existing product template, with low adaptation of this product abroad; they try to emphasize interdependencies and take advantage of products developed locally. Therefore, they stick to products developed in the parent country and there is little room for innovation and different technical and product templates. According to Whitley (2001), this feature enables to have more integration between the subsidiaries of the firm and the corporate offices, which is characteristic of German MNCs; integration that is reflected also in the mechanisms that they use to manage their operations abroad.

Finally, the HR department in German companies shows a pattern which has implications for the policies and practices of the HR area in general. For instance, it is argued that the personnel function in German firms has a more operative than strategic nature (Wächter and Muller-Carmen, 2002; Ferner et al., 2001; Ferner and Varul, 2000; 1999).

Lawrence (1991) describes the personnel function in Germany as more reactive, more legalistic and less autonomously professional. In part, this operative orientation of the function is associated with the highly regulated labour market in Germany, which in turn makes the main goal of the function the application of those regulations (Ferner and Varul, 1999). The concentration of activities, which are more administrative and legalistic, may have consequences for the implementation of international human resource management (IRHM) in German MNCs. It can be more difficult for these MNCs to manage some HR practices with a more strategic vision and to develop international pay and performance management systems as well (Ferner, 1997). In addition, the absence of performance-related payment systems as a type of control can be expected in German firms. The non-existence of an HR strategy means that HR practices among the subsidiaries are localised, which does not support integration of HR practices and policies between the headquarters and subsidiary, or across subsidiaries.

Whitley (1992a) has pointed out that in order to understand the nature of managerial structures and practices in diverse environments, it is important to look at the institutional contexts for explanations of the forms adopted by firms. The internationalisation strategy of firms, their structure, types of products, localisation of production sites, and the levels of integration and coordination among the corporate offices and subsidiaries are influenced by the country of origin of the MNC. Therefore, the control mechanisms developed by an MNC, it can be hypothesised, are also shaped by these forces. In the case of German firms, there are features from their institutional environment which have a clear effect on the control mechanisms that these firms might develop to control their operations. Taking this proposition a step further, MNCs from Germany still reflect in their control devices signs of this influence, which in turn makes it possible to develop ideal combinations of these mechanisms in relation to the country of origin of the MNC.

3.5.1.2 The Presence of Control Mechanisms in German MNCs

This section presents the combination of control mechanisms in German MNCs according to the influence of a variety of institutions from the country of origin. Harzing's (1999) typology of control mechanisms, described in Chapter 1, is the framework used to explain their presence.

The first type of control to be examined is the output control, with special emphasis on the nature of the financial controls in the German MNCs. There is a causal relationship between the characteristics of the output control and the type of corporate governance in firms. Because of the character of the coordinated market economy of Germany, which in turn affects the corporate governance of local firms, the reliance of German organisations on output controls is weak, and they are not orientated to monitor short-term performance. These controls are not implemented in the subsidiaries to monitor short-term results. Some studies have concluded that there is a tendency in German firms to have loose financial controls and not particularly strong pressures for results in the short term (Ferner and Varul, 1999; Ferner, 1997). In addition, Ahrens

(1997) posits that accounting practices in German firms are not an instrument to evaluate performance, but are set up as procedures to legitimise past actions rather than to control future performance.

This proposition has implications for the other forms of control. In the case of bureaucratic formalised controls (i.e.,, standard procedures, written policies and rules) German organisations show considerable reliance on them (Child et al., 2001). The great emphasis of these firms on technical functions means that they will attempt to perform on the basis of an existing product template. Thus, they will try to replicate this product template abroad and transfer practices that support this aim (Harzing et al., 2002). The standardisation of procedures plays an important role in pursuing this. If the firm develops templates and procedures which are homogeneous, they facilitate the integration among the different departments. In the particular case of MNCs, this helps to have more integration between the subsidiaries of the firm and the corporate offices, which is characteristic of German MNCs according to Whitley (2001). There is evidence for the extensive reliance of German MNCs on procedural controls to manage their international operations (Ferner and Varul, 1999; Harzing, 1999; Neghandi, 1983). In line with this, Ferner and Varul (2000) in a study of the personnel function in German MNCs, found that British managers perceived that it was difficult for German managers to embrace policies that required flexibility rather than bureaucratic uniformity.

The presence of the other two types of control, personal centralised control and control through socialisation and networks, is interconnected with the firm's reliance on output controls. In the case of the German firms, the limited presence of financial controls to monitor the performance of the subsidiaries is balanced with other devices that substitute this function. Personal centralised control through the presence of expatriates accounts for this. In the case of Japanese MNCs and the high presence of expatriates in their subsidiaries, Ferner (1997) addresses this practice as an intensive mode of control that allows for the imposition of the central authority through direct presence of these managers. The same proposition can be applied to the case of German MNCs. The expatriates are substitutes to alternative forms of control, such as financial controls to monitor performance.

Empirical research has shown differences in the presence of expatriate managers in subsidiaries according to the country of origin of the multinational. In the case of German and British MNCs, there are significant differences between the countries. For example, studies of German and Japanese MNCs have shown that they are more likely to send out expatriates to their subsidiaries than MNCs from other countries, particularly Britain and the US (Peterson, 2003; Peterson et al., 2000; Ferner and Varul, 1999; Harzing, 1999; Tung, 1982). As an explanation for the differences found it, is argued that German MNCs rely more on informal mechanisms such as communication and consultation to control operations. To support this informality, the firm needs to create channels which have to be trustworthy. Expatriates seem adequate to accomplish this function.

Control through socialisation and network has a diverse composition. The presence of socialisation as a control mechanism is medium compared to British firms. For German firms the meaning of corporate culture is different than for Anglo-Saxon corporations. Culture is something that has grown organically in the firm over a long period of time. It is based on tradition, long-term commitment, and stability (Ferner and Varul, 1999). The concept of corporate culture in German firms is less marketing oriented compared to the Anglo-Saxon counterparts and is less explicit. As it is seen as something that is developed over time, it can be expected that few explicit mechanisms support these activities. German subsidiaries will have less pressure to implement mechanisms at this level to support the development of similar corporate culture in the local units. However, the large presence of expatriates is an indirect way to develop control mechanisms through socialisation. Expatriates are socialised into the parent company culture before they are moved to the local units. They act as carriers of the "company way" of doing things and acculturate locals on the practices of the company. In this role, they also might develop networks with personnel in the headquarters offices and other subsidiaries that support the exchange of information on informal basis. However, the development of informal networks in the case of locals can be more difficult, there is some evidence that the flows of personnel in German firms are largely from the centre to the subsidiaries than vice versa (Ferner and

Varul, 1999). In other words in German firms, there is more exportation of expatriates than importation of these managers.

The presence of the last sub-group of control through socialisation and networks, e.g., formalised lateral or cross-department relations, is substantial in German MNCs. As was mentioned, there is a considerable integration of the operations of the German MNCs subsidiaries with corporate offices. This integration has to be supported with subtle mechanisms, in which formalised lateral or cross-department relations are useful devices. The integration of operations within the MNC supports the development of projects across subsidiaries. Ferner and Varul (1999) found, in their study of German firms with operations in Britain, that they tended to work together more as a team across divisions and centres than their British counterparts. The creation of these intra-firm projects in which expatriates and also locals participate supports the development of devices for informal exchange of information.

There is a distinctive pattern of the combination of control mechanisms in German MNCs, according to their characteristics. Table 3.2 presents the combination of them.

Table 3.2 Presence of Control Mechanisms in German MNCs

	Personal/Cultural	*Impersonal/Bureaucratic/Technocratic*
Direct/Explicit	**Personalised Centralised Control:** ***High*** (Peterson, 2003; Peterson et al., 2000; Ferner and Varul, 1999; Harzing, 1999; Tung, 1982)	**Bureaucratic Formalised Control:** ***High*** (Child et al., 2001; Ferner and Varul, 1999; Harzing, 1999; Neghandi, 1983)
Indirect/Implicit	**Control by Socialisation and Networks** • **Socialisation:** ***Medium*** (Ferner and Varul, 1999) • **Informal exchange of information:** ***Medium*** (Ferner and Varul, 1999) • **Formal lateral relations:** ***High*** (Ferner and Varul, 1999)	**Output Control:** ***Low*** (Ferner and Varul, 1999; Ferner, 1997; Ahrens, 1997)

The typology of Control Mechanisms is from Harzing (1999).

This section has listed and described the main institutions that have shaped organisations in Germany. According to the influence of institutions such as the state and the financial and education systems, local firms have distinctive characteristics which are reflected in their structure, business practices and type of agreements between employers and employees. The section has also described the main features of German MNCs according to the institutions of the country. Finally, ideal combinations of control mechanisms in the firms according to the effect of institutions have been discussed. These combinations have been developed taking into consideration how the nature of German firms, which is shaped by the main institutions of the country, is reflected in the way that German MNCs control their operations abroad.

In the next part, the main features of the Britain model are presented, and how its institutions have influenced the development of local firms. This section also discusses how this development has shaped the internationalisation of the British MNCs and the implementation of control mechanisms in MNCs subsidiaries.

3.5.2 Main Features of the British Model and their Effect on Local Firms

The institutional context of Britain has different characteristics compared to Germany. From an institutional point of view, Britain is classified as a liberal market economy. In this type of economy, firms rely heavily on market relations to resolve their coordination problems. Competitive market arrangements and hierarchies are the main forms of coordination among the different economic actors. There is an arm's-length exchange of goods and services, on a competitive basis and using formal contracting. Buyers and suppliers adjust their willingness to offer and demand goods and services, according to the price signals generated by the markets (Hall and Soskice, 2001). The case of Britain is characterised by little institutional support for non-market forms of coordination and an important goal of institutions is to monitor formal contracting among the different economic actors.

Britain has also been classified as an *arm's length* BS (Whitley, 2001), which provides highly flexible entry and exit arrangements for economic actors, but within a strongly institutionalised formal system of rules that support formal contracting. The state has more a role of regulator than coordinator, compared to Germany. The existence of formal contracting facilitates delegation and trust between owners of firms and managers. Owner control is exerted at arm's length through financial markets.

The nature of the institutions in Britain is different compared to the German ones. The financial system, for instance, is a capital-market based system (Zysman, 1983). As was described, this type of system allocates resources in competitive markets based on prices. Because of this, firms are attentive to the price of the shares in the equity markets and to current earnings. Mergers and acquisitions, even through hostile takeovers, are frequent when the market valuation of a firm declines. As the main source of financial funding for the firm is equity markets, which have dispersed investors, they require publicly available financial information on the performance of the firm. The absence of networks that can provide investors with such inside information on the progress of the firm reinforces these requirements (Hall and Soskice, 2001). There are important implications of the nature of the financial system in Britain for the corporate governance of firms. Anglo-Saxon firms are mainly managed in the interests of shareholders and focus on the maximization of short-term profits (Harzing et al., 2002). Compensation systems are designed to reward the top managers for increases in net earnings or share prices; therefore, the evaluation of their performance is linked to issues such as the current profitability of the company (Hall and Soskice, 2001).

Contrary to German companies, family ownership has declined among British firms. There has been a shift from personal shareholding to institutional shareholding, with an increase in the number of firms that are controlled through a group of interests (Scott, 1997). This has important implications in the way management is organised in Britain. There is a clear separation between management and ownership, with high levels of autonomy delegated to the chief executive, and the formulation of strategic decisions undertaken within committees of top managers. This level of autonomy of the managerial team comes with higher levels of accountability from this group concerning the performance of the firm. Incentives align the performance expectations of top management with those of shareholders (Vitols et al., 1997).

The state of Britain, compared to its German counterpart, provides a strong contrast which in turn affects local firms in a different way. Central government enjoys high levels of power with a high degree of policy autonomy. Therefore, there is little support from local governments and other independent authorities such as unions in the implementation of these policies (Wood, 2001; Lane, 1992).

The state in Britain has become a more regulatory state moving from one focused on leaving business alone to organise and regulate itself in the '80s to one in which independent agencies and laws regulate business activities. Its current nature is more like an arbiter of the rules of the game (Schmidt, 2002). The strong institutionalised formal system of rules and procedures in this type of BS support a role for the state which is more concerned with regulating the interaction of economic actors than coordinating them, thus enhancing competition in the market place. This type of state gives autonomy to individual firms, unions and other groups to freely organise (Whitley, 2005; 1999). There is a set of formal systems of rules and procedures, which allows firms, managers and owners to make strategic decisions on the operation of firms in a rational manner. However, there is little interdependence between collective actors, and few organisations are locked in to destiny of others.

The development of capabilities and competences is carried out individually by the firm and are not shared with other firms or customers and suppliers (Whitley, 2001). Institutions operate in a less coordinated manner when compared with their German counterparts. As a result, there is little development of local networks with other firms, or with state agencies and other organisations (Lane, 1998).

The education and training systems show distinctive characteristics. The formal education system provides education that is focused on general skills, which are more valued by employers and employees. Firms are reluctant to invest in industry-specific skills or to develop apprenticeship programs. The character of low-skill economy of Britain does not reinforce the learning of specialised technical skills on the employees. The education of managers in the country has a more generalist approach: it is more likely that they have accounting backgrounds and a takeover mentality (Lane, 1992; Fox, 1992). The more generalist background of British managers is reflected in the value that firms give to functions such as marketing and finance and the concentration of efforts to develop those activities within the enterprises (Harzing et al., 2002; Ebster-Grosz and Pugh, 1996).

The relationship between employers and employees has a different nature in Britain. Strategic decisions by firms to grow or increase profitability are linked frequently to mergers and acquisitions. These decisions affect employees, which can be dismissed because of downsizing practices. Employees face short job tenures and fluid labour markets, which reflect the short-term nature of the relationship among the two parts. The market regulates the nature of the relations between employers and employees, and this is reinforced by the lack of obligation that firms have to establish representative bodies for employees and the little power that unions have compared to their German counterparts (Hall and Soskice, 2001). Table 3.3 presents the characteristics of British firms according to the influence of institutions from the country.

Table 3.3 Main Characteristics of British Firms According to the Influence of Social Institutions

Institution	Characteristics of the Firm
Financial System	• A short-term horizon on the investment of firms, which looks for profits in the short-term • The monitoring of the firm is through publicly available financial information • The growth of the firm, frequently, is through mergers and acquisitions • Very independent relationship among firms, unions, suppliers and clients • Shift in ownership from personal shareholding to institutional one • Separation between ownership and management, high levels of autonomy to the top management
State	• There is no development of specific sectors or industries; there is no concentration of firms sharing similar skills and technology • Set of formal rules and procedures allows firms to plan and take decisions rationally • Firms can adopt leading edge business practices because of the low interdependence between collective actors
Education and Training Systems	• Managers and employees with a generalist background • Employees have short job tenures and face a flexible labour market, therefore, short-term employment contracts • Firms are concerned with the development of marketing and finance activities rather that production and Rand D functions

As in the case of the German institutions, the internationalisation of British firms is also affected by how they originated. The next section presents the main characteristics of British MNCs.

3.5.2.1 The Internationalisation of British Firms

The internationalisation of firms that belong to Britain have specific characteristic in how they have moved abroad. British firms have a tradition of international operations since the colonial era. They have preferred the FDI route to expand abroad, instead of following a strategy of going international through the export model. Between 1987 and the late '90s the investment of the manufacturing and services sectors increased just fewer than 40 per cent the former and around 45 per cent the latter. There are two industries, food, drink, tobacco and petroleum and chemical products, which account for more than 60 per cent of FDI in manufacturing sector. In the service sector, finance, insurance and business services account for 61 per cent of total investment (Dicken, 2003). In addition, they have been less focused in geographical terms on the home region, with more operations in dissimilar environments and have extensive geographical expansion (Lane, 1998). The long history of internationalisation in the case of British firms has made them less embeddedness in the home environment (Schmidt, 2002). This is also reflected in the geographical expansion of the British investment around the world.

As there is little concentration of firms by industry or sectors, the British firms have more experience in managing activities across different kinds of industry and business environments (Whitley, 2001).The British firms, typically, have grown through mergers and acquisitions and not always the diversification has been in related areas of the firm. The diversification of products, technologies and markets means that the top management has less detailed knowledge about specific industries and markets than managers from less diversified firms. Therefore, they delegate operational decisions to managers in the subsidiaries, which is reflected in their limited integration into the parent operations. Financial measures of performance and planning become relevant to counterbalance the levels of delegation to the local units (Whitley, 2001; Child et al., 2001).

Low levels of integration between the corporate offices and subsidiaries are also reflected in high local responsiveness and low headquarters dependence for British subsidiaries, which follow a more multi-domestic strategy (Harzing et al., 2002; Whitley, 2001).

British MNCs still show a concentration of operations, assets and workforce in the home country. However, compared to their German counterparts the proportion is smaller. The large British MNCs have more internationalisation in terms of assets and operations, particularly in the Rand D activities (Lane, 1998). MNCs from this origin are embedded in a less regulated environment in which unions are less powerful; therefore, there are fewer restrictions on moving capital and resources abroad.

The HR function in British MNCs is more strategic in its design. There are elaborated formal mechanisms for measuring and rewarding management performance, such as performance-related payment systems (Edwards et al., 1996; Sisson, 1995). In addition, compared to German firms, British MNCs follow decentralised bargaining structures. There is also evidence in British MNCs of the implementation of innovative HR practices, such as profit-sharing schemes and quality circles programs, (Marginson et al. , 1993). This more integrated vision of the function means a set of global rules that can be designed at corporate level which are shared by the MNC subsidiaries.

The link between institutions and the development of firms has been presented in this section. As in the German case, there is a highly distinctive pattern of internationalisation among the British firms, which is also reflected in the way that these firms manage their operations abroad; this influence can be observed in the control mechanisms that British MNCs implement in their subsidiaries.

3.5.2.2 The Presence of Control Mechanisms in British MNCs

Previous findings suggest that there are some differences, looking at the control mechanisms in British MNCs, compared to the devices implemented in the German MNCs. The first type of control to be examined is the output control, with special emphasis on the nature of the financial controls in the firms.

As can be expected, the financial devices in firms from a liberal market economy show sophisticated mechanisms to control the financial operations in the MNCs subsidiaries. The firm's valuation in equity markets becomes crucial to secure funding, either from the stock market or through bank lending. In addition, the lack of corporate networks capable of providing investors with inside information makes them more dependent on quarterly balance sheets and public information (Hall and Soskice, 2001). Therefore, the credibility of this type of information has to be high, and firms need to develop complex financial mechanisms to support their sales forecasts and profits predictions for coming years. These mechanisms are designed to monitor short-term results and cost-efficiency, which is linked to Whitley's (1992b) proposition on the propensity in British firms to "internalise" risk rather than share it with financial institutions.

There is a stronger need to develop frameworks of rules and systems to align decision-making in the subsidiaries to the goals of the firm. British enterprises depend on bureaucratic formalised control to manage their operations abroad. In this way, they allow local responsiveness in the subsidiaries, but at the same time, they assure some consistency in practices and decisions within the MNC. It has been found that impersonal control mechanisms, which include output and standardisation devices, are mechanisms heavily used by British and US MNCs (Harzing et al., 2002).

The existence of the other two mechanisms, expatriates' presence and control by socialisation and networks, is affected by the existence of output controls and bureaucratic formalised devices. There is evidence about the limited presence of expatriates in British MNCs. Egelhoff (1984) points out that European MNCs make greater use of expatriates than their British and American counterparts. These findings are supported by other research on European MNCs (see, for example, Ferner and Varul, 1999; and Harzing, 1999). The implementation of sophisticated financial controls, which monitor closely the subsidiary operations in general, and specifically its financial outputs, makes less necessary the presence of expatriates to exercise this function. In addition, the tendency of British firms to diversify products and services means they operate in a decentralised style. To support this decentralisation, it is more appropriate to implement impersonal mechanisms, such as standardisation of procedures, written policies, and standard rules.

The use of expatriates as a control mechanism has a partial influence on other control devices such as socialisation. Assuming that the expatriates act as carriers of the organisational culture, through their knowledge of "the company way", their absence in MNCs subsidiaries limits the transfer of this learning. However, the vision shared by British MNCs of the corporate culture as a management tool that can be introduced to support organisational change reinforces the creation of devices to achieve this objective (Ferner and Varul, 1999). Thus, socialisation as a control device in British MNCs is medium. The other type of network control, informal exchange of information, is affected by the multidomestic structure adopted by firms. The development of an informal network, which might be a subtle form of control among the subsidiaries, is constrained by the decentralisation of operations and by the little presence of expatriates in the British MNCs.

Finally, formal lateral relations might not be abundant. As the British MNCs have a propensity to give autonomy to their subsidiaries and are likely to operate on a decentralised way, the presence of formal lateral relations is rare. Table 3.4 indicates the composition of control devices that might be found in British MNCs according to features from their country of origin.

Table 3.4 Presence of Control Mechanisms in British MNCs

	Personal/Cultural	*Impersonal/Bureaucratic/Technocratic*
Direct/Explicit	**Personalised Centralised Control:** *Low* (Ferner and Varul, 1999; Harzing, 1999; Egelhoff, 1984)	**Bureaucratic Formalised Control:** *High* (Harzing et al., 2002)
Indirect/Implicit	**Control by Socialisation and Networks** • **Socialisation:** *Medium* (Ferner and Varul, 1999) • **Informal exchange of information:** *Low* (Ferner and Varul, 1999) • **Formal lateral relations:** *Low* (Ferner and Varul, 1999)	**Output Control:** *High* (Hall and Soskice, 2001)

Typology of Control Mechanisms from Harzing (1999).

Institutions influence the development of local firms, and the internationalisation of them. The adaptation of MNC subsidiaries to the country of operations is strongly determined by the features that they bring from their country of origin. However, the country of operations and the nature of its institutions might have a different effect on the operations of the MNC subsidiaries (Whitley, 2005; Morgan, 2001). According to the inheritance that the MNC subsidiaries bring with them, they might react in different ways to the particularities of the new environment. The next section analyses the main institutions of Venezuela, the country of operation of the case studies, and how they affect the activities, business practices and capabilities of local firms. MNC subsidiaries operating in this context are exposed to the same set of forces as Venezuelan firms. However, their background might affect in different ways how they react to the new environment.

3.6 The Characteristics of Venezuelan Institutions and their Influence on Local Firms

The Venezuelan institutional context has important differences, compared to German and British institutional environments. Whitley (2001, 1999) has drawn from the study of Chinese family business a classification of such an institutional context called particularistic. One of the main characteristics of this environment is the lack of strong institutions that support the coordination of economic actors or regulate their interactions. Whitley (2001) stresses that formal institutions are unreliable and too weak to structure the behaviour of economic agents in these kinds of societies. As we explain further Venezuela institutional environment is a type of such environment.

The development of distinctive patterns of economic organisation is conditioned by two main features (Whitley, 2005). On one hand, the complementarity created by key institutions governing property rights, capital markets, labour markets and authority relationships is fundamental to develop differentiated systems. On the other, the role of the state in providing a stable and predictable environment for economic actors, supporting internal cohesion, and implementing consistent policies is crucial for the development of these patterns of economic organisation.

In the Venezuelan institutional context, it is difficult to find these conditions. There is little coordination and complementary among Venezuelan institutions. The structure and outcome of institutions such as the educational and financial systems have not become adapted to the interests of the productive system, either through actions by the state or any other coalition of actors. In addition, the role of the state to support a predictable environment has been poor and the policies implemented have been erratic. The political story of the country and the constitution of the state, it has not been able to enforce its hegemony over other institutions and the various groups in society to develop the type of complementary institutions that exist in Europe, the US and Japan. This fragmentation amongst institutions means that "the rules of the game" are not clearly developed and actors have to learn how to operate around institutions as much as in them (Morgan and Marquez, 2003). The result is no trust in formal institutions and procedures, which makes social relationships in this type of context highly personal and particularistic (Whitley, 1999).

The Venezuelan state is one of the most important institutions in the country. This state has been characterised by its weak institutionalised formal system of rules that support the interaction of different groups. This is explained, in part, by the changes in the political regimes in the country in the last two centuries. Venezuela has been a country subject to radical changes in its political actors since its independence from Spain in 1830. Presidential regimes did not follow formal periods for specific numbers of years. For instance, a conservative party governed the country until 1864 and from then, the liberal party led the country until 1899. In that year a coup took place and a military government ruled until 1945 (Carrera et al., 1998).

Military governments ruled the country until 1958, when a democratic regime was implemented. Democracy continues under a dual-party system of conservatives and liberals. This dual-party system continued until the late nineties when an ex-military officer won the elections with a coalition of different political groups which grouped people with left-wing and right-wing orientations (Bautista, 1997).

The political regime, with governments with different political ideologies, does not support the development of a strong regulatory framework. Before 1945, with each new government the constitution was changed and the political institutions were dissolved. During the time of the dual party system, consistent policies concerning the regulation of the interaction of different economic actors were not developed. There was no compromise by each new government with the policies, plans and programs of the previous one. The economic guidelines and priorities in education, health and other social programs changed from one presidential period to the other. For instance, in 1997 the new government changed the constitution after 50 years and carried out significant reforms to the legal system (Petkoff, 2000; Bautista, 1999).

Another distinctive characteristic of the state in Venezuela is its leading role in the industry development in the country. Political reforms have been made to support the interventionist role of the state (Petkoff, 2000). This role has been supported by two factors. First, the state has the right to exploit and manage the revenues from oil, huge resources which can support the industrial development. Venezuela has one of the biggest reserves of oil and gas, and it is one of the top four countries in terms of the production capacity of oil, together with Saudi Arabia, the US and Russia (Francés, 1999).

Foreign companies initiated the exploitation of oil in the country in 1907, through concessions given for periods of more than 40 years. However, the Venezuelan state recovered the oil concessions in 1974, and because of the oil booms in the following years became financially strong. A national company was created to manage the oil, *Petróleos de Venezuela (PDVSA)*, the second oil company in the world (United Nations, 1999). *PDVSA* has down-stream integration, with activities of exploration, production and commercialisation. During the same period, parastatal companies were created in the iron, aluminium and financial industries, and regional corporations were organised to reinforce the development of certain geographical areas. The state developed ambitious economic plans to strengthen and diversify the economy. However, this interventionist role of the state was not complemented by changes in other institutions, such as the education system. In addition, the changes in the objectives of the industrial policy because of the preferences of the government did not support the development of specific industrial sectors in the long-term.

Second, the state, in order to support the development of national competitive advantages, followed an inward development policy. The recommendations from the United Nations Economic Commission for Latin America and the Caribbean (ECLAC) on an inward policy, promoted its intervention in protecting national industry in order to foster its development (Izard et al., 1976). From the '50s until the late '80s the state followed polices, such as high tax barriers for imported products, indirect subsidies to different sectors of industry, cheap loans and tax exemptions (Francés, 2001).

Protectionism of industrial sectors hid a lot of inefficiency, reflected in the lack of quality of products. Therefore, the competitiveness of the Venezuelan industrial sector in foreign markets was low. For instance, the productivity of these sectors in Venezuela was half that of other Latin American economies, and one third of the productivity in industrialised economies (Baptista, 1999).

The interventionist role of the state and the frequent changes in the objectives of industrial development exposed the state to rent-seeking activities of social groups. This behaviour of economic actors reinforced the low capacity of the state to coordinate activities between social groups, because cooperation amongst them would mean each obtaining fewer resources. The incentives are oriented towards competition and towards obtaining the largest quantity of resources from the state.

This instability of the system has affected the growth of companies, and due to the impossibility of the state to provide a stable and predictable environment, lobbying practices from firms have been important to obtain protection. It has been difficult for Venezuelan firms to develop complex and stable organisational capabilities because their strategy is focused on gaining political power or other forms of support rather than exploiting market opportunities. In addition, they are diversified vertically and horizontally because responsiveness and flexibility are keys to cope with the volatility of the environment (Naím, 1999).

Another main institution in Venezuela is the financial system. It can be classified as a credit-based system with strong intervention from the state. This intervention was, first, based on fixing interest rates. After the '80s, it became indirect through the interest rate of loans that the central bank gives to commercial banks and through the interest rate of the government bonds, which are offered to finance the public deficit.

The main source of funding for firms has been banks. Until 1995, they were structured as business groups that provided different financial services. The idea behind this type of organisation was a holding structure with diversification of the operations in the sector. The state also created public banks to support economic development and regulated interest rates for specific sectors such as the agriculture (Kelly, 1997).

The banking system is relatively concentrated. In 1992, of the 44 banks in the country 7 held more than 50per cent of the savings and loans of the financial system, and it was much the same in terms of capital. Many regional banks has operated until 1995, and satisfied local necessities and provided capital for small and medium enterprises. However, the regulation of the financial system changed in 1995, supporting the implementation of a universal bank model. This regulation forced the banks to increase their social capital. In many cases mergers and acquisitions occurred, leaving small and medium enterprises without support and concentrating even more the bank system (García et al., 1998).

The small size of banks forces large firms to borrow money abroad. In addition, the instability of the economy frequently leads to the devaluation of the national currency. Firms hold considerable amounts of money in international banks to protect against the internal economic volatility. These foreign deposits make it easier to obtain funds from international sources. These characteristics of the system have also conditioned the type of investment of firms. They look for short-term results and profits to protect themselves from the volatility of the local economy.

The main source of profits of local banks is financial transactions, because of the short-term nature of the funding of firms. This reinforces the limited support provided by the financial system in developing industrial sectors. The family ownership of Venezuelan companies and their small number have not contributed to the development of stock markets and consequently, takeovers are not frequent. Another characteristic of the Venezuelan financial system is that the shareholders of banks borrow money from them to invest in their own business (Kelly, 1997).

The nature of the Venezuelan state has created crony capitalism. In this type of capitalism those who are close to political authorities receive economic favors from the government. Usually, these favors are not complete transfers of wealth, such as forgiving taxes or providing subsidies, they occur by the provision of economic entitlements (Krueger, 2002). For instance, it has been common in Venezuela to assign contracts in different sectors such as electricity, oil and other mineral resources to people close to the government in charge.

The existence of crony capitalism is reinforced in countries with political instability, such as Venezuela. Political instability tends to create commitment problem among social actors. In this type of context, social groups will have strong incentives to punish their opponents, reward their allies, levy high taxes on everyone else, and confiscate property in order to finance their political and military activities (Haber, Maurer, et al., 2002). A type of particularistic institutional context is created as consequence of the crony capitalism in which the regulatory framework is weak and the social institutions do not act as a coordinated system.

As a consequence of the institutional system, the business groups in the country are characterised as having mutual shareholders and a wide diversification in different industrial sectors. They are family-owned enterprises, which have growth according to the business opportunities that the government may offer, with family members in top managerial positions in the associated companies. In 1980, of the 70 biggest manufacturing firms in the country, including parastatal enterprises and MNCs, 39 were family business (Naím, 1999). The expansion of the group, frequently, is to support the operations of other firms within the group. Firms coordinate their activities using their personal ties. Therefore, cooperation among these companies is based on personal connections.

The market orientation of firms is local because of the weak development of stable and complex capabilities in firms. There are difficulties to obtain from the social institutions in the country the right resources to support the development of capabilities. In addition, the volatility of the economy, which has affected the planning of firms in the long term, is another factor that influence the absence of competitiveness of Venezuelan firms.

The characteristics of the education and training systems in Venezuela are very different from countries such as Britain and Germany. It shows poor coordination with other institutions and economic actors such as firms. There is a system of vocational education and training (VET), but this is not considered part of the formal education system. There is no involvement by unions in the curriculum design, and the relationship between industry and technical institutions is weak.

The poor coordination between the education and training systems and unions and firms, and the decentralisation of the national curriculum has resulted in a heterogeneous workforce. Public and private institutions have different curriculum designs for the same careers. Training in technical skills is scarce. Therefore, there is a shortage of workers with sector-specific skills. Firms need to invest in training to compensate for shortage of people with the right skills. However, the weak coordination among firms limits their investment because other firms can take advantages of investment in training (Granell and Parra, 1999).

The educational background of managers is more generalist than specialist. The Venezuelan government has instituted many initiatives to train people abroad. These initiatives have opened the possibility to implement foreign business practices (Navarro et al. , 1992). This generalist approach is also supported by the poor development of the industrial sector, which does not encourage the development of managers with a strong technical background. However, there is an exception to this tendency in the oil industry.

MBA studies are the preferred background for managerial positions, and specialisation in areas such as marketing, finance, human resources and production is accepted too (Granell, 1997). However, the loyalty of managers working in family-owned firms is an important asset for a long-term career in such companies, even more valuable than training, skills or experience (Naím, 1999).

The relationship between employers and employees, in the case of Venezuela, has been shaped by considerable regulation from the state. The nature of this relationship has changed over the years. During the years of protectionism of the state over the local industry, although firms were not competitive, they were profitable and they had long-term employment contracts (Naím, 1999). However, this situation changed as a consequence of the more open policy to foreign investment and the globalisation of markets in the end of '80s. Many firms closed and employees initiated moves to other firms. The relationships between the two parts changed to a short-term basis, making difficult the development of internal careers. Managers move between different industries and their expertise is not confined to a specific sector or area (Granell and Parra, 1999; Granell, 1997).

The different characteristics of Venezuelan institutions have been highlighted and their effect on Venezuelan firms described. Table 3.5 summarises these points. The Venezuelan state has taken a leading role trying to develop the industry in the country. However, it has failed in its attempt to develop a cohesive set of institutions, which work in a coordinated way and provide a stable and predictable framework for economic transactions. This fact has reinforced the development of rent-seeking elites. Firms do not act in a consistent form, and there is no clear pattern of coordination and competition amongst them. For instance, they can compete fiercely until one of them disappears, or they can implement cartel arrangements about production quotas, prices and market share. However, competition on prices or quality rarely occurs. Because of the characteristics of the system, these agreements are short in their nature and long-term cooperative relations between firms and sectors have few possibilities of happening (Naím, 1999).

Table 3.5 Main Characteristics of Venezuelan Firms according to the Influence of the Main Institutions

Institution	Characteristics of the Firm
State	• Rent-seeking activities with the sate • Poor development of strong and complex capabilities • Firms are oriented to satisfy local markets • Growth of the firm through diversification (horizontally and vertically) • No concentration of firms according to industry or sector of operations • Support of personal networks to overcome the incomplete contracting
Financial System	• Small firms • Short-term horizon in the investment of firms • Shared holding between banks and business groups • Family-owned enterprises
Education and Training System	• Shortage in technical skills • Possibilities to introduce leading business practices in firms • In-house training without cooperation among firms in the same sector • Managers have a generalist background • Short-term employment contracts

The incentives of the firm and other economic groups are not oriented towards cooperation; by contrast, they compete to obtain the largest quantity of resources from the state as individual groups and not as coalitions. The weak regulatory environment of formal contracting also supports the rent-seeking behaviour of firms, and personal networks are crucial to business development in this context. Networks of friendship, family and political connections, become an important asset to cope with the particularistic nature of the institutional system.

These local features in different degrees affect the operation of MNC subsidiaries in Venezuela. Degree of adjustments by the local unit to the local conditions may occur. Moreover, when they come from different environments. They have to interact with local firms that have distinctive characteristics, deal with local institutions such as the state, and employ a heterogeneous local workforce as well. The outcome from this interaction is shaped by the origins of the firm, which will support some forms of adaptation over others.

3.7 Conclusions

This chapter has pointed out the significant importance of the country level of analysis in understanding the shape of MNCs and their subsidiaries. In this sense, institutions from the origin country shape the operations of MNCs. In the case of the two countries of origin of the case studies of this thesis, there is a set of institutional characteristics that affect the internationalisation process of firms: they are summarised in Table 3.6. As can be seen, there are distinctive characteristics in German and British MNCs in terms of strategy, structure, business practices, and markets and products' orientation.

Table 3.6 Main Characteristics of German and British MNCs

German MNCs	British MNCs
• Little experience managing operations in adversarial or different institutional environments from the German one	• Early experience on internationalisation
• Concentration of FDI in familiar business environments	• Diversified FDI which might be in different institutional contexts from Britain
• Late internationalisation compared to their British and the US counterparts and they rely mainly on a exporting strategy	• Internationalisation mainly through a FDI strategy
• Close relationship to German banks either because they are capital suppliers or because of the existence of interlocking directorships	• MNCs with activities in different sectors and industries
• Closely supervised and integrated into the parent country activities, with concentration of the Rand D activities and workforce in Germany	• Less supervision and more delegation of operative decisions to subsidiary level
• There is low diversification of products and low adaptation to contexts abroad	• High adaptation from the subsidiaries to country of operations, following a multi-domestic strategy
• HR function is more operative (legalistic) than strategic (align with the strategy of the firm)	• HR function more strategic with the implementation of novel practices in the area

The distinctive features of MNCs from the two countries will influence their interaction with the Venezuelan context, which has its own institutions that demand particular behaviours from firms to cope and survive. Pulling forces from the two contexts affect the presence of control mechanisms in the MNC subsidiaries, country of origin and country of operations. Because of this, a point of departure in the analysis of the behaviour of MNC subsidiaries is the country level of analysis. Specific economic configurations support distinctive characteristics in MNCs. However, it is important to highlight the fact that as firms operate in different industries and sectors, and according to the amount of interaction between firms and institutions, the influence of the institutional context can be less or be more powerful. Therefore, the industry is another level of analysis that has to be included in the study of the implementation of control mechanisms in MNC subsidiaries. In the next chapter, the evolution and main characteristics of oil service and business software industries are explained.

Chapter 4: The Oilfield Service and Business Software Industries

4.1. Introduction

The research questions of the thesis look for explanations on the effect of institutions (country of origin and country of operations) in the implementation of control mechanisms in MNC subsidiaries. They also look for other variables, more contingent, that have an effect in the implementation of these devices. In order to answer these research questions, Chapter 2 explains the criteria for the research design and the selection of the cases. One criterion is the selection of MNC subsidiaries from different sectors. The rationale behind this decision is that it can be expected that there will be a sector effect on the implementation of the control mechanisms in MNCs as was explained in Chapter 1. The selection of the sectors follows Porter's (1986) typology of multidomestic and global industries. Broadly speaking, it may be assumed that MNCs in a multidomestic industry will be more decentralised in control terms compared to firms in a global industry. This led to the selection of the oilfield service and business software sectors as the industries for the cases.

In the case of the oilfield service is considered a multidomestic industry. In spite of the global dispersion of the operations of oil MNCs, the nature of the services that they offer, oil services of exploration and extraction to governments or national oil companies (NOC), is a key determinant on the characteristics of this industry. They also have to import technology and know-how to operate locally, but it has to be adapted to the local characteristics of the oil fields and to the type of oil to be extracted. Therefore, firms in this industry are highly dependent of the local context. By contrast, the business software industry has a more global nature. On one hand, because of the characteristics of its product, they have to expand geographically and offer products and services on a global basis. Moreover, the product that they offer is more standard and requires less adaptation that in the case of the oilfield service. Thus, dependency of the local environment is less strong.

This chapter presents the industry as one of the levels of analysis. The aim of this chapter is to understand the characteristics of the two industries in the country of operations. It explains how the industry's structure has affected the strategy of firms, particularly MNCs. The chapter analyses the dynamics in the oilfield services and business software industries in general, and particularly in Venezuela.

This chapter is organised as follows. Firstly, it explains the nature of the oilfield service sector in Venezuela. In this section, there is a review of the evolution of the oil industry and the forces of change in the industry are also identified. It highlights the evolution of the oil industry and its effect in the development of this sector in the country. The second section presents the business software industry in the country of operations. It also describes the forces of competition and the trends in the industry and its effect in the Venezuelan industry. Finally, the main conclusions of the chapter are summarised.

4.2 The Oilfield Service Industry in Venezuela

Before presenting the analysis of the oilfield service industry in Venezuela it is important to review the evolution of the oil industry and in that process, identifies the forces of change in this industry. This process of change is an important explanation of the characteristics of the oilfield service industry in Venezuela.

4.2.1 The Evolution of the Oil Industry

The evolution of the oil industry is a good example of how the global business environment has changed from one of growth and stability dominated by large MNCs to one of macroeconomic instability and increased global competition. The radical changes in the industry have affected the type of competition and the operations of firms in the industry.

Two major actors dominated oil production during the twentieth century: countries with oil reserves, and oil MNCs that had the technology and experience for the extraction of oil. In the first part of the century, the oil industry had an oligopoly structure with seven major players called "the seven sisters". Five of them were from the US: Exxon, Mobil, Texaco, Amoco, and Chevron; one Dutch/British: Royal Dutch/Shell; and one British: British Petroleum. They monopolised the extraction and production of oil in the largest oil basins in the world, located in the Middle East and South America and they organised a cartel to control oil prices, based on their dominance over the production of oil, creating an oligopoly structure in the industry (Turner, 1978).

There was a tendency of the oil MNCs to grow as mega companies, diversified horizontally and vertically. In 1980 the oil firms dominated the ranks of the world's largest firms, with revenues greater than the gross domestic product of many nations. The largest ones were vertically integrated with a range of activities, from exploration, production and refinery activities to retail activities. They also diversified horizontally, with activities in the petrochemical, minerals, mining and metal industries (Cibin and Grant, 1996).

Although the dominant power of the oil MNCs in the extraction and production of oil lasted for almost half of the last century, in the late '30s, the power of the oil MNCs to control oil production and price started to shift slowly to the oil countries. Host governments took actions to increase tax payments from the oil MNCs or carried out legal actions to expropriate concessions given to the MNCs at the beginning of the century. In some cases the legal actions of expropriation were successful and the oil government then set up NOCs to manage the oil reserves of the country. This was the case with Uruguay, Peru, Bolivia and Mexico in Latin America in the '30s, and later in some Middle East countries (Turner, 1978).

However, the greater demands from the oil governments on the profits generated by the extraction of oil did not reduce the power of the oil MNCs to control its price. In response, the major exporting countries formed an entity to confront the international oil companies and defend the price of oil (Yergin, 1991). In 1960, the five large oil country producers (they accounted for 80 per cent of world's crude oil): Iran, Iraq, Kuwait, Saudi Arabia, and Venezuela, created the Organisation of the Petroleum Exporting Countries (OPEC), which had two main aims: first, to control the price of oil through fixed production targets, and second to negotiate with the big oil companies the terms of the contracts for the extraction of oil (Stonham, 2000; Espinaza, 1996). This cartelisation on one hand was effective and decreased the power of the MNCs to bargain the oil price, and on the other hand, increased the power of the suppliers of oil.

The commodity nature of the oil plays an important role in understanding the power gained by the oil country producers. First, there is an absence of close substitutes for this commodity. Second, the supply of oil cannot be easily altered to respond to variations in the demand or unforeseen shortfall supplies. Oil producers tend to operate at full capacity because of the high fixed costs. Third, oil stocks are very expensive to store because of its liquidity and inflammable nature (The Economist 1991). Therefore, the increase of oil production in the short-term is difficult affecting its price.

Following the '70s the oil industry faced high levels of instability and change. Different forces, outside and inside the industry, changed its structure and the nature of the relationship between suppliers and buyers. The changes in the industry also affected the structure of the oil MNCs and incorporated new actors to the supply side. The next section analyses the forces of change in the oil industry and how they have affected the oil MNCs.

4.2.2 The Forces of Change in the Oil Industry

This section analyses the main forces of change in the exploration and production sector of the oil industry. The changes in the structure of the industry are intimately related to modifications of the relationship between the main players, such as buyers and suppliers. The most important explanations of the transformation in the industry are attribute to first, the entrance of new oil producers, which increased the oil supply making the oil cheaper. Second, the decrease of barriers to entry for newcomers to exploit oil reserves; third, a more rapid diffusion of innovation and technology which opened the possibility for small oil players to access specific technology and to concentrate on specific segments such as exploration and production activities; fourth, the volatility of the oil price.

The rivalry of firms in the oil industry increased, significantly, especially in the exploration and production activities. Firm rivalry rose with the creation of new oil MNCs to compete in the exploration, extraction, refining and marketing of oil. An important group of large MNCs was NOCs set up to manage the exploration and production and even marketing operations in the countries with the largest oil reserves. For instance, this is the case of *PDVSA* in Venezuela, Kuwait Oil in Kuwait, and Saudi Aramco in Saudi Arabia. In addition, another group of medium-sized oil MNCs was created, such as Elf Aquitaine from France, ENI from Italy and Nippon Oil from Japan (Cibin and Grant, 1996).

Another group of smaller firms operated in specific segments of the industry. The proliferation of stock after the '80s opened the possibility of new sources of funding such as venture capital funds, which were willing to financed projects that promised high returns. Then, small firms were created to operate in particular segments of the oil industry, such as upstream exploration and production activities, refinery or marketing (Ernst and Steinhubl, 1999; Beakley, Gee, et al. . 1997) . The oil industry was segmented with firms operating only in one or two segments.

Small companies emerged in Europe and in the US with particular expertise such as marginal, deep-water and offshore fields, among other specialisations. The creation of these specialised firms was also supported by the existence of financial investors willing to invest in small companies that had the expertise to carry out exploration activities with lower costs than the large oil MNCs.

For instance, the creation of small oil firms in the Britain is explained in part by this phenomenon. Many of them were created to explore the oil and gas reserves in the UK on their on or in partnership with large MNCs. However, the fact that they had expertise in specific techniques opened the possibility for them to participate in production projects abroad and not only in exploration activities in the parent country (Knott, 1996).

In sum, the rivalry between established competitors has increased with more firms, medium-sized MNCs and small firms, competing to participate in the exploration and production activities, in many cases with cheaper operating costs than the large MNCs.

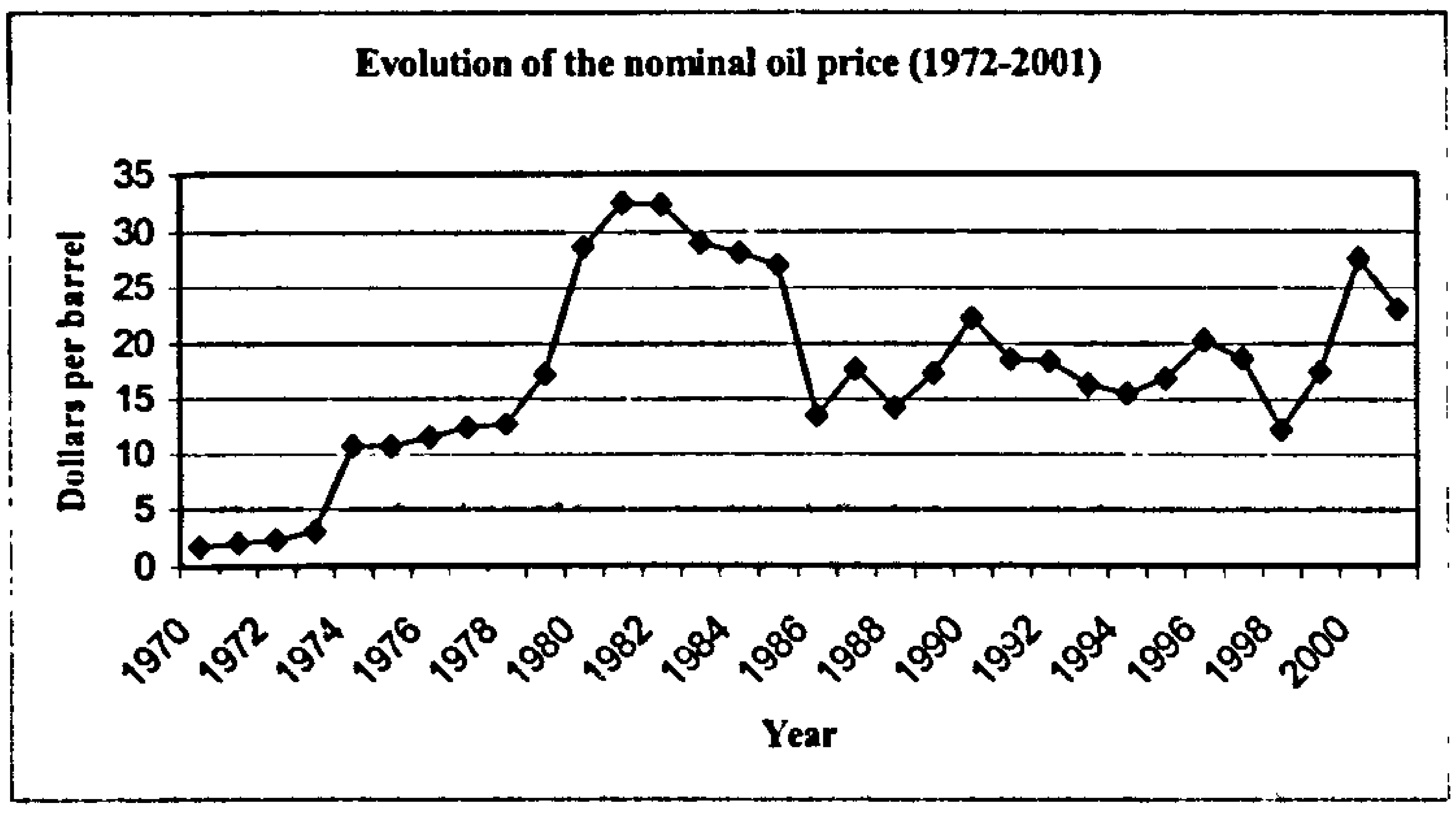
The barriers to entry in the oil industry decreased. Traditionally, the exploration and production activities in the oil industry have been carried out under the supervision of oil governments. The typical type of agreement grants a concession to an oil MNC in areas with proven oil reserves, and the oil firm carries out activities of exploration, production and refinery. However, it has been a tendency in the countries with the largest oil reserves such as Iran, Kuwait, Venezuela and Algeria, to set up their NOCs and carried out their own exploration and production activities. Frequently the local exploitation and production of oil has been closed to foreign investment.

Nevertheless, as the price of oil has been affected by increasing competition in the oil industry, the profits of the NOCs have fallen. They have changed their way to operate to cope with the lower profitability. NOCs have created partnerships, production-sharing contracts or joint ventures, and subcontracted other oil companies to perform some of their activities. For instance, in the exploitation of mature fields or fields that require specific technology. This type of partnership has been very attractive to the oil MNCs as a strategy to enter the oil sites, which were closed, to foreign investment. This is the case of countries such as Mexico, Iran, Libya, Kuwait and Venezuela (Stonham, 2000). As the most profitable area in the oil industry lies in upstream operations such as the extraction of oil, the opening of foreign investment to specific activities in exploration and production has been opened business opportunity for many oil MNCs (Cibin and Grant, 1996; Yergin, 1991).

The partnership between the oil MNCs and the NOCs has two characteristics which are important to highlight. On one hand, the oil MNCs are contractors of the NOC which in turn is the main buyer of the oil produced by the MNC. Therefore, the local operations of the oil MNCs are set up mainly to respond to the local demands of their local client. On the other hand, the outcome of the operations of the MNC in the local site is intimately related to the conditions in the country of operations.

Other characteristic of the oil industry after the '70s has been the volatility of prices. Three factors account for this. First, oil prices are linked among other variables to the success of exploration activities in discovering oil basins that not always have the desired results. New oil discoveries are future oil surplus, which is going to bring down the oil prices. Second, the demand for oil varies with the consumption of countries, which in turn is linked to periods of recession or boom in the economic world such as the case of the economic growth of China. Third, OPEC members and NOCs manipulate their oil production to affect the price (Stonham, 2000). Figure 4.1 shows the evolution of the oil price during the period 1972-2001: the oil price volatility is observed in the peaks of periods of high prices followed by periods when the prices fell significantly.

Figure 4.1: Evolution of the Oil Prices during the Period 1972-2001



Source: OPEC Report (2001).

The volatility in the oil prices took the oil MNCs and NOCs to a process of rationalisation of costs. Various tactics were adopted such as asset rationalisation, staff downsizing, reengineering, total quality management, shared services and outsourcing. In spite of the cost reduction process that traditional oil MNCs and NOC went through, the former continue to look for new fields in which to explore and extract oil. It was particularly relevant to search for opportunities of investment in low cost environments in which the extraction of oil was cheaper. These environments, usually, were in countries with considerable reserves and NOCs exploiting them, such as Venezuela.

4.2.3 The Oil Industry in Venezuela

The Venezuelan oil industry until the '70s had an oligopoly structure with foreign MNCs such as Royal Dutch Shell, Creole, Texaco, Mobil and Exxon exploiting the oil in the country. In 1974, the Venezuelan state recovered the oil concessions and began the *Nacionalización del Petróleo,* (i.e.,, the nationalisation of oil), as was discussed in Chapter 3. The structure of the industry changed from an oligopoly to a monopoly, with the creation of a NOC: *PDVSA*, to manage the oil production in the country.

The activities of *PDVSA* were integrated vertically, including upstream and downstream activities, and mirrored the largest oil MNCs in its structure. Until 1993, *PDVSA* carried out all the exploration and production activities in the country and had some operations abroad, such as its subsidiary in the US, Citgo Petroleum Corporation, the fourth-largest gasoline retailer in the US, with activities of refining and marketing. In the '90s the NOC developed a strategy to increase its production capacity, and became one of the main oil suppliers for the US. The maturity of the industry and the reduction of the power of OPEC to control prices, because of the entry of new oil supplies, were reasons to change the strategy of *PDVSA*. In addition, the NOC, to become more cost-efficient, invited private investors, national and foreign, to participate in exploration and exploitation activities of marginal fields, which required specialised technology.

The strategy of *PDVSA* was to concentrate on the more lucrative fields in which the costs of the extraction of oil were cheaper. In 1992, a first round offering marginal oilfields to private investors was carried out. In 1997, a third round gave the concessions to oil private companies of a set of marginal fields, which had low production levels. The opening to private investment did not increase the number of oil suppliers because they were contractors of *PDVSA*.

In the search of MNCs for new areas to exploit, the "Venezuelan opening" was an attractive opportunity. The country holds the largest oil reserves in the Western hemisphere and possesses the largest gas reserve base in Latin America (Croft and Stauffer, 1995). Venezuela was very attractive for oil investors because of its oil reserves, its political stability at that time, the advanced oil structure of *PDVSA* and, more important, the strategy of the oil firm to increase its oil production, which meant a regular demand for the oil produced by the oil MNCs.

The type of agreement for the entry of the private oil companies in 1997 was significantly different from the agreement drawn up the first time that MNCs came to the country. In the first legal agreement in 1922 between the oil MNCs and the Venezuelan government, the state received taxes and royalties from the extraction of the oil, and the MNC commercialised the commodity and received the largest per centage of profits.

By contrast, agreements made between *PDVSA* and the private companies in "the opening" had a different format. It stated that the participating companies did not have ownership of the oilfields: instead, they had to carry the costs associated with exploration activities and they received a fixed fee per barrel with provision for capital recovery in the production stage (Espinaza, 1996; Peggy, 1994).

The third round was a success: 130 of the pre-qualified firms were foreign companies and 70 were Venezuelan. The international firms were composed of 85 operating firms, and the rest were financial organisations which were looking for opportunities to invest in the country. Lasmo was a medium-size British oil firm among the first group, which envisaged in Venezuela an opportunity to change its role of investor to being an operator of oilfields. Preussag Energie, a division of the German Preussag AG, was also in this group.

The entry of private investors did not change the industry structure significantly because *PDVSA* kept its monopolistic power. On one hand, the new entrants were contractors of *PDVSA* and some of the investment they carried out was refunded by the NOC. A dependent relationship was developed between the two parts because the oil companies needed the approval of *PDVSA* for their investment plans in order to receive the refund of part of their investment. On the other hand, the new entrants could only sell their production to the NOC, increasing its monopolistic nature. *PDVSA* exerted its bargain power by fixing the levels of oil production of the new entrants in the Venezuelan oil industry. The complexity of the relationship between the oil contractors and *PDVSA* is greater because of the weak nature of the regulatory framework in the country, as was stated in Chapter 3. The use of legal mechanisms to fulfil the terms of the agreement is difficult in the country. In addition, *PDVSA* is a national company in which the state participates in the election of its board of directors and CEO. The fact that the NOC is a member of the OPEC cartel increases pressures to follow the strategy of the cartel, which lately is based on reduction of the oil production of the members when the oil price is down. Thus, the strategy set by the NOC is vulnerable to changes according to the view of the government regarding what the oil strategy of Venezuela should be: increase production and have a cheaper oil price and a larger market share, or decrease production and boost the oil price. The government's position affects the strategy of *PDVSA* and consequently its relationship with the private investors. This effect is analysed in the presentation of the oil MNC subsidiaries in Chapter 5.

4.3 The Business Software Industry in Venezuela

The main product of the business software industry is development of software, in the form of packages of standardised software. These packages include application packages and systems software. A complementary product of business software is the professional service of activities such as software customisation, which is the adaptation of some functionalities of the package to special customer requirements, and activities connected to the software use like consultancy, technical assistance and training services to users (Brouthers and Kruis, 1997).

The business software industry in Venezuela has had limited development because of the small size of the industrial sector in the country. In the next section, we explain the forces of competition in the industry and how the trends in this industry have influenced the entry of the business software MNCs in the country.

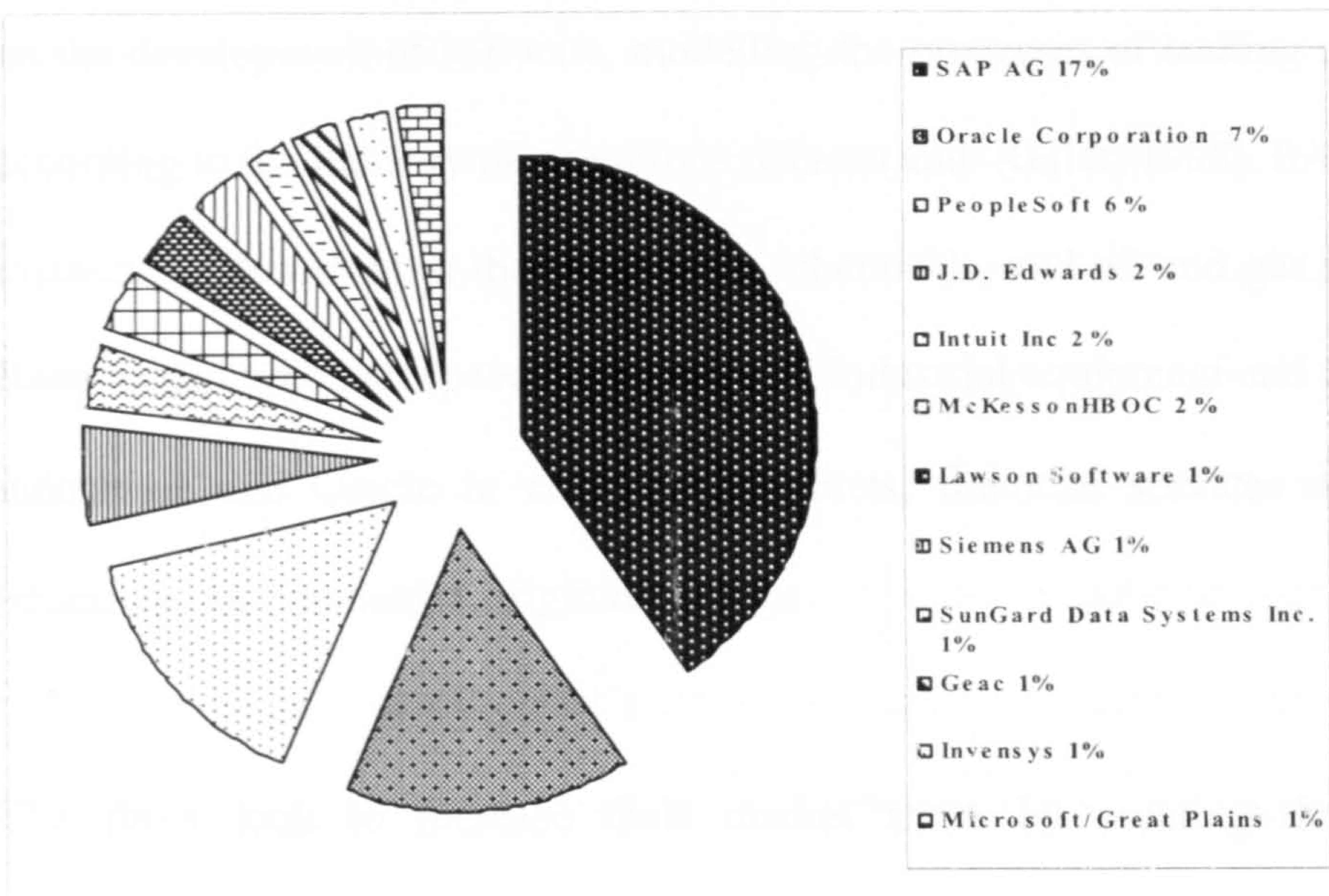
4.3.1 The forces of Competition in the Business Software Industry

Enterprise systems (ES) is one category of business software. In the '70s, a production-oriented information system was known as a manufacturing resource planning (MRP) system. ES is the latest enhancement version of the original MRP system. Essentially, it is a single database that collects data and feeds it into modular applications created to support several business activities across functions (e.g., production, finance or human resources) in one firm or group of business units, even those dispersed geographically (Davenport, 1998).

A rapid growth of ES implementation in firms started in the early '90s. During this decade, firms were under pressure to become more cost-efficient and response to changes in the environment. Downsizing practices became common during this period. Firms needed information on a real-time basis to take decisions, and integrated information from different levels, units and functions. The ES was an excellent tool to achieve this goal. The sales of ES jumped from $2.8 billion in 1991 to $11.8 billion in 1996. During the same period, the compound annual market growth rates were 33 per cent in the US, 28 per cent in Europe, and 65 per cent in Asia (Baxter, 1997). International Data

Company, a consultancy firm in the area, estimates a growth of 10.9 per cent in the ES software during 2001-2006 (Byron, 2002). Despite the explosive growth of ES, the market has an oligopoly structure with three of the largest firms sharing 30 per cent of the market. Figure 4.2 presents the leading ES vendors in 2001, according to their market shares.

Figure 4.2 Market Shares of the ES Leading Vendors in 2001



Source: Byron (2002).

The characteristics of the business software as a product largely explained the behaviour of firms in the sector. First, firms in the business software industry are driven by the creation of economies of scale on the demand-side in order to stay in the market. Because an attribute highly valued by the users of technology is the wide use of the product by other customers. The multiplication of the users of the product adds more value to the network and increases the probabilities of the firm to establish its business software as the de facto industry standard (concept from network externalities Shapiro and Varian, 1999a; Shapiro and Varian, 1999b).

This characteristic of the product has created a tendency of the ES providers to specialise according to industry sectors. The specialisation of ES providers by industries is related to the nature of the business software. ES has developed by modelling best-business practices in an industry: what ES vendors do is focused on the development of software, modelling the processes of leading companies according to the industry of operations (Curran and Keller, 1998). SAP AG, for instance, is dominant in the automotive, chemicals, and oil and gas industries; Baan leads in the aerospace, high-tech and industrial equipment and machinery industries; and Oracle in consumer products, financial services and higher education, and research (Siriginidi, 2000).

The firms look to increase their market share by creating demand-side economies of scale (Shapiro and Varian, 1999a). This effect brings popularity and value to the business software, which in turn makes more attractive the provider's package to new consumers within the industry, creating a spiral of sales for the ES of a specific vendor. Once a customer is "married" with an ES provider, there is a lock-in effect, which makes it difficult for the user of the software to change to another because of the high costs involved in a new implementation. The US was the first big market to be entered, particularly for European firms like SAP and Baan, which were the first developers of ES. The other main competitors of ES, such Oracle, PeopleSoft and J.D. Edwards, came from the US, which was another reason for the European firms to enter this market.

Second, the development of the product is another issue that demand attention. The development of business software requires high investment in Rand D activities. Two main streams of activities are the core of Rand D in this industry. On one hand, it is important to continue the development of new products to be offered to the market. On the other, activities have to be developed to refine functions on existing products. The ES is based on modelling the best practices of an industry, and because of the rapidly evolving industry standards, there is always room to improve the technology and functionalities of the software. ES vendors are regularly upgrading the versions of the package to add new functionalities to satisfy customer demands or to offer a better technology to run the software. The upgrading of version of ESs becomes an additional source of profit for firms offering the service (Kumar and Van Hillegersberg, 2000).

In addition, the rapid pace of innovation in the industry has important implications for the relationship between ES vendors and users. The continuous supply of technology products either to upgrade versions of the software or to offer new products causes the vendors to develop a long-term relationship with their clients. The purchase of software is also linked to additional services, such as service and support centres, consultancy and training activities, which are offered on a regular basis. The long-term relationship with clients asks for presence of ES firms on the sites in which they have customers. Software providers face strong demands to have global operations in order to provide services and support to their clients.

4.3.2 The Trends in the Business Software Industry and their Effect on the Industry in Venezuela

One of the major trends in the industry is the adaptation of the software that business software vendors have to make to their products. Initially, the largest companies, which have considerable flows of information and multiple procedures, were the first clients for the software companies. However, in the late '90s two events affected the structure of the ES segment. First, the large firms in the US, Europe and Asia had installed the software and the potential to grow in this segment started to decline. ES vendors had to look to other market niches such as large MNCs in other continents (e.g., Latin America), and to offer the software to other segments (e.g., small and medium-sized enterprises). In order to operate the small and medium enterprise niche, ES vendors had to adapt the software and reduce the costs associated with its implementation, and introduced a range of individual solutions to make the software accessible to the more modest budgets and limited operations, and resources of these firms (Nairn, 2000).

Second, the introduction of e-commerce increased the demand for applications that facilitated business-to-business trading and connections between clients and suppliers using Internet portals. This second factor affected the competition in the industry. Now, the competitors in the ES industry were not only the ES providers. The range of competitors became larger: internet application vendors, providers of single solutions in areas such as HR and finance, and numerous small firms that offered products with new or advanced features. These changes in the industry structure make more important the development of a long-term relationship with customers.

The development initiatives vary to support the development of larger number of products. For instance, some of the firms continue to carry out the Rand D activities in-house, and inject more money into the development of new products. In many cases, the expansion of the Rand D activities means a decentralisation of these, and the MNC sets up centres abroad grouped by types of research. Another strategy implemented by the firms in the industry is to make alliances with other business software providers and offer a kit composed of the ES software and complementary applications from the other provider. Another more radical strategy is to buy business software companies which have developed the product. The last strategy allows the ES firm to introduce the software quicker into the market and saves the time that it could take to develop the software in-house.

The need of the business software MNCs to expand geographically, as explained above, is a reason to explain the set up of the business software subsidiaries in Venezuela. In spite of the nature of the Venezuelan economy, as has been discussed in Chapter 3, that shows an industrial sector of a few large firms, the pressures on these MNCs to become the facto industry standard were a main reason to come to this country. Indigenous firms operate essentially in the domestic market. In 2002, the total Venezuelan exports were $25,203 million, and only $4,560 million were from the private sector: the rest was from the export of oil. 80 per cent of Venezuelan firms are small and medium enterprises, which are concentrated in the industries of chemicals, food and beverages, textiles and metal products (see: www.conindustria.com)

Venezuelan MNCs are few, some in media and telecommunications (e.g., Diego Cisneros group), mass consumption (e.g., Polar group) and the oil industries (e.g., *PDVSA*). Therefore, the adoption of the standard business software package, which initially was designed for large firms, is limited because of the small size of the firms in the country. The business software subsidiaries as their first clients had the largest firms of the country. However, they had to move to a larger niche of medium and small enterprises. The implementation of business software packages among smaller firms demands adaptations to it. These pressures to adapt are reinforced by the network effect in the industry. The integration of suppliers and clients of the business software user into the network, which in many cases are small or medium firms, implies offering a product that fits the needs of these firms. The small size of the Venezuelan market makes the competition among software providers very strong and the need to expand markets through offering services and products to other countries in the region, such as Colombia, Peru, and Central America.

4.4 Conclusions

The analysis of the forces of competition in the business software and oil industries stresses major differences between the main drivers of competition in the two of them. It also shows how the firms in the two industries react in diverse manners to cope with the changes in their structure. The industry analysis has to be seen as an intermediate level of study, between the effect of national institutions on the operations of firms and a more micro level of analysis, which is more focused on the analysis of variations within the firm.

The two industries, oilfield service and business software, presented in this chapter have been exposed to different forces of competition. A summary of the main characteristics of the two industries is presented in Table 4.1.

Table 4.1 Main Characteristics of the Oilfield Service and Business Software Industries

Characteristics	Oilfield Service	Business Software
Type of Industry	Multidomestic	Global
Industry Life Cycle	Mature	Mature
Product Differentiation	Homogeneous product (commodity)	Potential for differentiation (different business software solutions and specialisation by industries)
Barriers to entry	Decrease of barriers to entry (smaller size of the investment)	Switching costs and lock-in effect
Supplier Power	Segmentation of the industry, more competition from medium and small firms	More competition from firms in other sectors (e.g., Internet application vendors and providers of single solutions

Adapted form Grant (2002).

The evolution of the two industries has influenced the strategy of the firms. The ES industry, for instance, has reached a mature stage with the saturation of its original market, and has had to look for new developments to reinvent its product. The need to develop business software with new functions is reinforced by advances in technology such as the Internet, which creates pressures to incorporate functionalities that use this feature. The rivalry in the business software industry is more intense with the entry of competitors that already provide Internet products before. Table 4.2 describes the main strategies adopted by firms operating in each industry.

Table 4.2 Main Strategies of Firms in the Oilfield Service and Business Software Industries

	Oilfield Service	Business Software
Product Strategy	• To search for low-cost environments • To work for NOCs under service agreements	• To develop new software products • To set long-term relationships with clients
Organisation structure	• To implement flätter structures and cost reduction programs, which could imply decentralisation of decisions and activities	• Decentralisation of Rand D activities • Levels of integration between corporate offices and subsidiaries to facilitate the flows of knowledge, products and personnel
Strategy of Internationalisation	Pressures to move to low-cost environments	An accelerated international strategy to become the standard software in the industry

The forces of competition in each industry expose firms to similar trends. For instance, business software firms face demands to accelerate their internationalisation process and become the leading software for a specific industry. In this way, the business software provider develops demand-side economies of scale, which in turn make its product the technical standard product. In addition, the development of a long-term relationship with clients to become their main software provider is another strategy followed by firms in the industry. This strategy of growth explains the entry of software MNCs to Venezuela.

Firms in the oilfield service industry face different trends and adopt different strategies. On one hand, the intensification of the number of competitors in exploration and production activities, and, on the other, the opening to foreign investment of oilfields that traditionally were in the hands of NOCs, have both changed the structure of the industry. Increasing competition has affected the profitability of firms and two main strategies have been developed. First, the firms have designed projects to reduce costs and develop flatter structures. Second, they search for oil sites where the exploration and production activities are cheaper.

Overall, there are common trends that firms in the same industry have to face. However, according to the characteristics of the country of operations of the MNC subsidiary, the industry might have particular characteristics, as was discussed in the analysis of the two industries in Venezuela. The strategic choice of each firm to tackle them may lead MNC subsidiaries in the same industry to follow different actions. For instance, the monopoly structure of the oil industry in Venezuela, creates a set of challenges to MNCs in the country that they may not face in other countries. All these elements from the country of origin and country of operations, in addition to the characteristics of the industry, affect the design and implementation of the control mechanisms in the MNC subsidiaries, as is presented in the next chapters.

Chapter 5: The Oil MNC Subsidiaries: Preussag Energie Venezuela and Lasmo Venezuela

5.1 Introduction

This chapter presents and discusses Preussag Energie Venezuela (hereafter PEV) and Lasmo Venezuela, the MNC subsidiaries from the oilfield service industry. The aim of the chapter is to describe the different control mechanisms implemented in the two subsidiaries. This chapter and the following one provide the basis for the comparison chapter, Chapter 7, where the findings of the cases are compared.

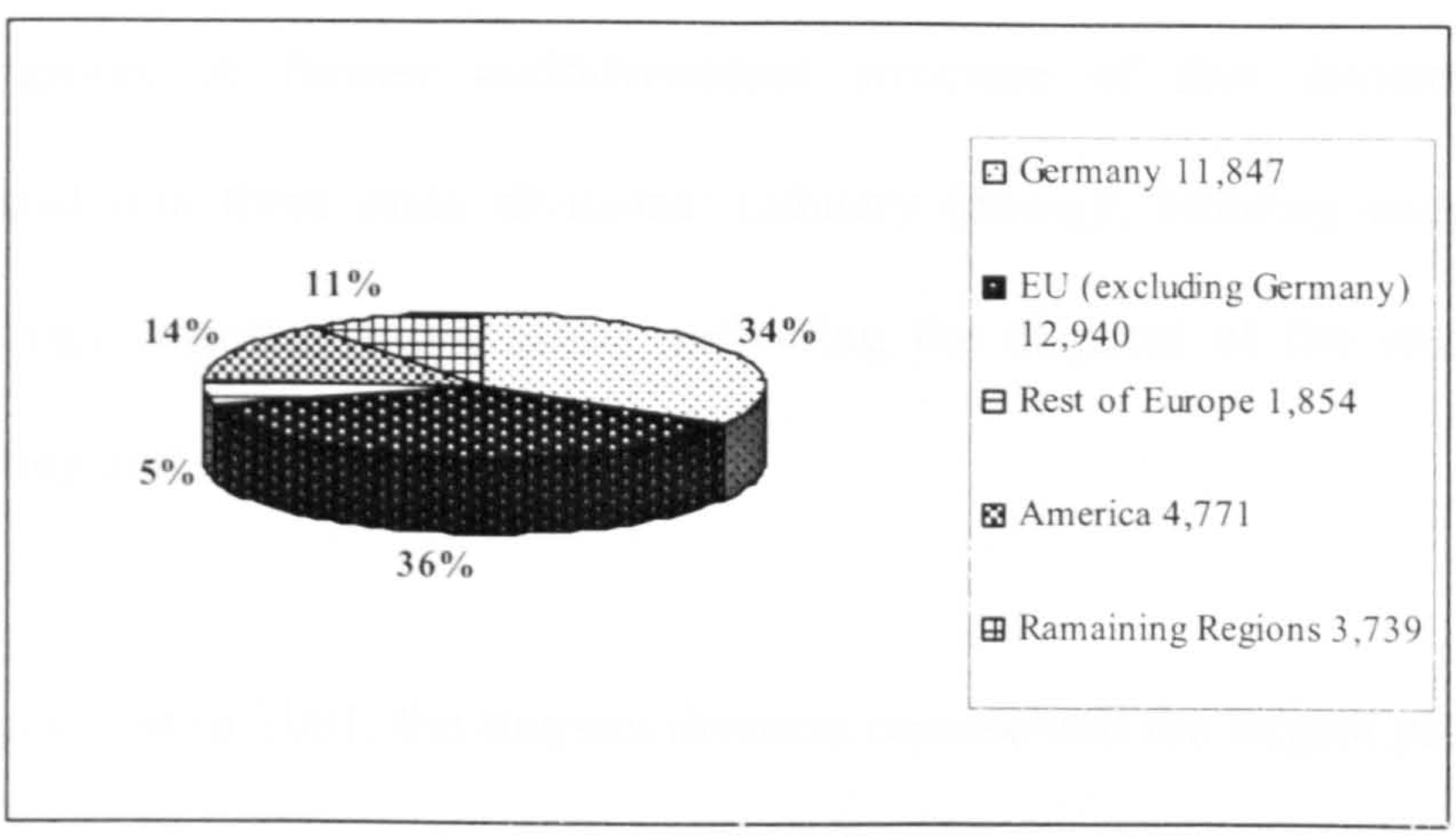
The chapter is organised as follows. Firstly, it presents Preussag AG, a German conglomerate, and its ownership structure. Secondly, it describes Preussag Energie, the division which carries out the oil operations of the MNC. The next section concentrates on the evolution of PEV and the development of capabilities in the subsidiary. The fourth section presents the control mechanisms implemented in the German subsidiary. The same structure is followed to present the second case, which is Lasmo Venezuela, the oil subsidiary of a British MNC. Finally, the main conclusions of the chapter are highlighted.

5.2. Preussag AG

The Preussag group initiated its operations in the commodity industry in 1959 during the privatisation of industrial properties by the German Federal Government (The Times, 1959). The group followed the route of many German firms diversifying operations in industrial sectors such as steel, plant construction, engineering, energy and metals trading. The conglomerate grew as one of the largest in Germany. In 2001, the firm had 77,295 industrial workers and employees around the globe (Preussag, 2001).

Preussag's internationalisation began in the early '90s with the acquisition of an important portion of the shares of a Dutch mining group. In the subsequent years, the firm acquired other firms in different countries such as Canada (a lead smelting firm), Egypt (oil concession), the US (oil concession) and France (non-ferrous metal and heating technology firm). By 1997, more than half of the turnover of the firm was coming from abroad (Preussag, 1998). Figure 5.1 shows the distribution of the turnover by region.

Figure 5.1 The turnover of Preussag by regions in 1997/1998 (in DM millions)



Source: Preussag Annual Report (1998).

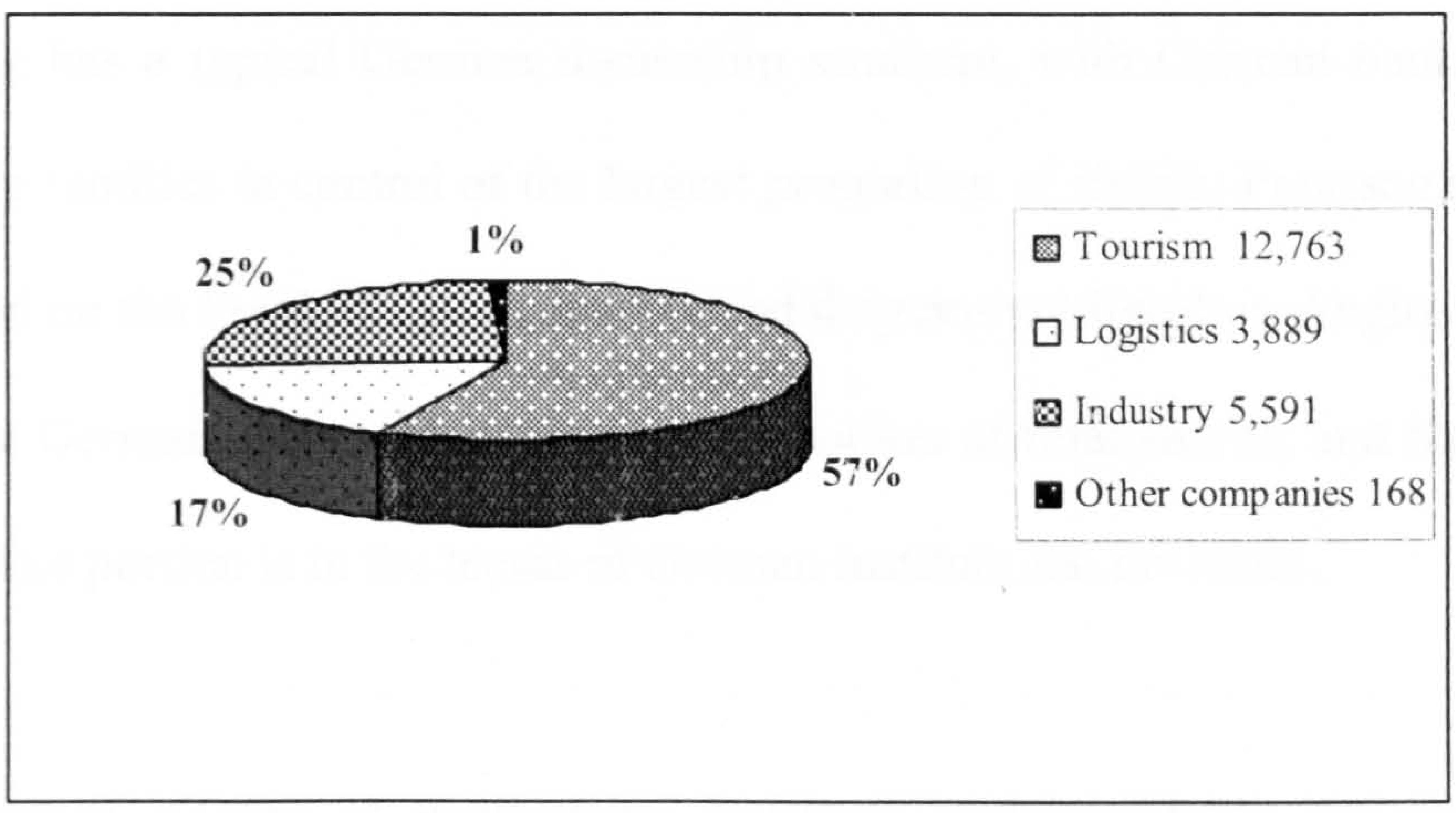
In the mid '90s the maturity in Europe of the raw material markets such as coal and steel impacted the profitability of the conglomerate. In 1997, the conglomerate initiated a radical change. It tightened its portfolio, divesting activities in steel, non-ferrous metals and coal mining sectors, and concentrating its growth on sectors such as energy and building engineering. The conglomerate also invested in the service sector in areas such as logistics and tourism. The expansion in the tourism sector was through acquisitions such as the container shipping and tourism businesses of Hapag-Lloyd in 1997, and later in 1998, the Thomson Travel Group, a tourism company. The chairman of the group, in the company report of 1998, describes the concentration of operations:

> *We concentrated on strengthening the defined growth areas energy and commodities, building engineering and logistics. With the acquisition of Hapag-Lloyd we gained a new division- tourism- which will give added impetus to Group growth. We continue to distinguish between areas of consolidation, selective growth areas and dynamic growth areas within the Group (Preussag, 1998).*

The new strategy of Preussag was also reflected in the change of the structure of the group. A former multidivisional structure of five divisions was reorganised into three main divisions: industry (energy, building engineering and trading), logistics and tourism, reflecting the disposal of the steel, plant engineering and shipbuilding businesses.

Four years later in 2001, the tourism division represented the largest proportion of turnover (57 per cent) of the group. This figure demonstrated the new product orientation of Preussag. Figure 5.2 shows the group turnover by regions. The proportion of employees in Germany changed, too. In 1998, from a total of 66,563 employees, 43,428 (65 per cent) were in Germany. In 2001, the proportion changed to be only 23,894 (34 per cent) employees in Germany and 45,656 employees abroad (Preussag, 2001). These changes of the distribution of the workforce are evidence of the acceleration of the internationalisation of Preussag.

Figure 5.2 Group Turnover by Regions 2001 (€ millions)



Source: Preussag Annual Report (2001).

Preussag, before 1997, had features typical of German MNCs as they were presented in Chapter 3. On one hand, it experienced a late internationalisation process compared to firms from Britain and the US, with a concentration of employees and turnover in Germany. On the other, Preussag concentrated operations in familiar environments such as Western Europe. However, the realignment of the strategy of the company showed a growing effort to become disembedded from its context. The action of the company to move to the service sector seems to look for short-term results. The shares of Preussag doubled their price after the group entered the tourism industry segment (Wall Street Journal, 1999). In addition, the firm experiences a fast internationalisation. Two reasons might explain this acceleration. On one hand, the concentration in the tourism industry demands a more international workforce. On the other, Germany is a high-cost environment in labour, therefore to move operations abroad reduces costs and increases profits.

5.2.1 The Preussag Ownership Structure

Preussag has a typical German ownership structure, with German banks and founding families in control of the largest proportion of shares. Preussag shares are listed on the Frankfurt stock market and they are not listed on Anglo-Saxon markets. German shareholders hold three-quarters of total shares, and 85 per cent of this portion is in the hands of German institutional investors.

The German portion of institutional investors remains highly concentrated (31.37 per cent) in the hands of the German financial service provider WestLB Group. The other shares are in the hands of foreign investors from the UK, Switzerland, France and the US.

The firm has the typical German dual board structure. The supervisory board has a strong German composition with a representation of the different shareholders: unions and Preussag AG personnel representatives, and the chairman of the executive board of WestLB AG are part of this board. Evidence of the long-term employment contracts of German firms, highlighted in Chapter 3, is in the fact that many of the executive board members have been in the group for more than 15 years, and the current CEO was a former employee of the WestLB group, the financial investor that holds a high concentration of Preussag AG shares (see: www.tui.com). Preussag, despite its strong international expansion, remains very German in the composition of its board.

The internationalisation of the firm has been accompanied by a change in the accounting principles of its financial statements. They changed to follow the German GAAP to follow International Accounting Standards (IAS).

The presentation of Preussag and the analysis of its evolution show that the firm has distinctive characteristics that are rooted in the German BS but also is taking action to become disembedded of its context of origin. In addition, Preussag, to cope with mature markets, did not follow a strategy to reorganise its businesses: it took its particular way to cope with the new circumstances. The next section describes Preussag Energie, the division that is in charge of the oil operations of the MNC.

5.2.2. Preussag Energie

The energy division of Preussag has its corporate offices in Lingen, Germany, and it employs around 700 people. The division had a late internationalisation in the early '90s. The oilfields in Germany became mature and it was very costly to exploit them, so, the division searched for opportunities abroad.

Preussag Energie has concentrated its operations on the upstream sector, on exploration and production activities in the oil and gas sectors. This operations were usually carry out with partnership with other oil companies that have the technical expertise.

The German Operations Vice-president of the Venezuelan subsidiary described the business of Preussag Energie:

> *It* (Preussag Energie) *is not downstream, that means it is not a company for refineries or trading, it is more or less an upstream company. It is a German based company and in Germany there is no future in this type of business because most reservoirs are very old. The domestic companies to survive have to go international.*

Its internationalisation began first with partnerships with Norwegian Oil companies in the North Sea and later with exploration activities in Kazakhstan. The sites where the MNC operates fields are Kazakhstan, Tunisia, Yemen, Albania, Qatar, Australia, Philippines, New Zealand, Argentina, Colombia and Ecuador, and recently Venezuela. In 1997, 65 per cent of the crude oil production of the division came from outside Germany (Preussag, 1998). Preussag Energie has concentrated its operations in low-cost production countries. The initial internationalisation strategy of the firm was through partnerships with other oil companies, which carried out the operation of the field, and Preussag Energie invested funds. However, in the late '90s the company opened subsidiaries to carry out exploration and production activities in Ecuador, Qatar, Tunisia and later in Venezuela.

An important element in the decision of Preussag Energie to invest in or to operate an oilfield is the type of field. The division has developed technical expertise in marginal fields and in fields in urban areas, which require a particular technology to prevent damage to urban infrastructures on the surface. The Venezuela opening was very attractive because of its concessions of marginal fields, in particular a oilfield in an urban town. The local finance and accounting manager of Preussag Energie Venezuela expressed the opportunity that Venezuela represented for the company like this:

> *For a firm that has low operating costs* (Preussag Energie) (*compared with firms like Shell and Exxon), Venezuela was very attractive because of its huge oil reserves and the supply of good oilfields. They* (Preussag Energie) *did not want to be an oil company which transported oil, traded oil, nothing like that. They knew that to become an operator in Venezuela was only to operate a field, so it was ideal for a small oil company.*

According to the strategy of the company to invest in low-cost environments, Venezuela looked very attractive in the international expansion of the energy division because of its well-known reserves, low exploitation costs and the match between the technical competencies of Preussag Energie and the possibility to obtain a concession of a marginal field.

5.3 Preussag Energie Venezuela (PEV)

Preussag Energie entered the third Venezuela opening of marginal fields in 1997. It won a concession as an operator of an urban oilfield called *Cabimas,* located on the East Coast of the country. The Operations Vice-president of the subsidiary explained the strategic value of the field for Preussag Energie:

> *Cabimas field is very similar to the oilfields that we have in Germany. We are used to working in dense urban centres, like this one, and also we have the technology to operate the field (El Nacional, 1997).*

The subsidiary initiated operations formally in 1998. A group of expatriates were sent to PEV to set up the activities in the subsidiary. The majority of these expatriates did not have experience in international assignments and also did not know the local language. In the administrative area, the Vice-president was a German expatriate, who carried out the initial recruitment of local people. In the technical area, a German vice-president was appointed out to organise the technical operations, which involved the transfer of a number of technical experts from Germany, and to hire a drilling company to start exploration activities in the field.

Since initial operations the subsidiary has had autonomy from the corporate offices. The decentralisation of decisions went together with a centralisation of responsibility in the hands of the expatriates. A local security manager described the role of the Vice-presidents in this way:

> *I think they have so much autonomy. They have a scheme in which they have to report everything. However, they have freedom to buy a building without approval from Germany. They have complete power to the extreme that I think they can sell the subsidiary if they want to.*

The MNC structure adopted by the division reflects the multidomestic nature of the sector. However, this high level of autonomy is compensated by the presence of expatriate managers in key positions in the subsidiary, indicating a more complex picture of the way in which corporate offices control the subsidiary.

5.3.1 Preussag Energie Venezuela market positioning

The type of agreement between PEV and *PDVSA* has important implications for the operations of the subsidiary. First, the German subsidiary is a contractor and its production levels are set by the NOC. PEV is responsible for the extraction and production of the oil and *PDVSA* pays an operating fee per barrel that covers operating expenses and profit margin (Croft and Stauffer, 1995). This is because the third round in Venezuela did not give to the oil MNCs the ownership right to the field. There is a strong bargaining power on *PDVSA*'s side. Second, the agreement permitted the recovery of capital and operating costs under a scheme of incremental production above a certain level. As the oil MNCs were operating marginal fields, in many cases they have to upgrade facilities and develop new ones; the approval of the national oil company was needed for the upgrading investments because the money expended would be returned to the MNCs.

PEV's dependent relationship with *PDVSA* shapes in many ways the operations of the subsidiary. One aspect of this is the strong need for adaptation in order to fulfil *PDVSA* demands. As was explained in Chapter 4, the strategy of *PDVSA* changes and oscillates between an increase of production levels to a reduction of these levels. The concession of the oilfields to private investors was very attractive because at the moment of the concession, the *PDVSA*'s plan was to increase its production levels. However, this strategy changed the following years and reduction of the production was a new strategy of the NOC, affecting the levels of production of the subsidiary. By the time Preussag set up operations in Venezuela, the price of the oil was decreasing. OPEC in order to stop this fall of the price, decides to cut down the production levels of its members. This event affected the strategy of *PDVSA* and consequently the production oil demanded to the oil MNCs. PEV vulnerable position affects the presence of expatriates in the subsidiary, on one hand, and the evolution of the subsidiary on the other.

5.3.2 The Evolution of Preussag Energie Venezuela and the Development of its Capabilities

The volatility of the local context has played an important role in the evolution of the subsidiary and the type of capabilities that it has developed. PEV was important in the portfolio of operations of Preussag Energie, which is under pressure to internationalise. It was one of the main operations abroad and it was also seen as the entry to obtain further oil and gas concessions in the country.

The initial idea of PEV was to outsource many of the operations in the administrative and technical areas and remain as a small subsidiary with few fixed operating costs. However, this idea in the first year of operations changed due to mainly three reasons.

First, the relationship with *PDVSA* has been difficult to manage. Political changes have occurred in Venezuela over the last few years, which have affected the operations of the NOC. The management of *PDVSA* is highly politicised. Access to senior positions in *PDVSA* is dependent to a high degree on political patronage. Therefore as governments change so does the top management of *PDVSA* and so too does its attitude towards managing the relation with the foreign MNCs (Espinaza, 1996). In line with this, the demands of *PDVSA* in terms of reports encouraged the creation of a specialised report unit to produce such reports. The implementation of the SAP ERP system in *PDVSA* to integrate its operations created a unified reporting system for *PDVSA*'s contractors.

Second, PEV's initial operations did not have tight internal controls over costs, investments and profits. However, the company had to tighter these controls because the manner in which it was paid by *PDVSA*. A planning and budgeting department was created, with the appointment of German expatriates from corporate offices, and an internal controller was sent to the subsidiary to manage the internal accounting system, which was constructed to fit in with German GAAP requirements.

Third, PEV had difficulties in managing the relationship with the *Cabimas* community. Although *Cabimas* was an urban field, it had different characteristics compared to the German urban fields, which made difficult the extraction of oil. High levels of unemployment and a community with high expectations that the company would solve many of its problems of poor infrastructure and lack of public services, brought pressures to bear on PEV. Strikes and sabotage in the oilfield operations were common. The social institutions in the country were not efficient in solving the problems of the community and PEV had to cooperate and act in favour of the community.

The strategy of the German subsidiary to cope with the context has been to adapt to local demands and try to please *PDVSA* in order to win approvals on investments. As a local capability, the strategy of PEV has been to create an informal network with *PDVSA* and other national decision levels. In the words of the local administration manager:

> *We try to cover all communication channels, try to create ways to communicate with them, try to look for support in the Energy and Mining Ministry, German Embassy, different governments levels like Cabimas county and state governor, to try to put these people on our side.*

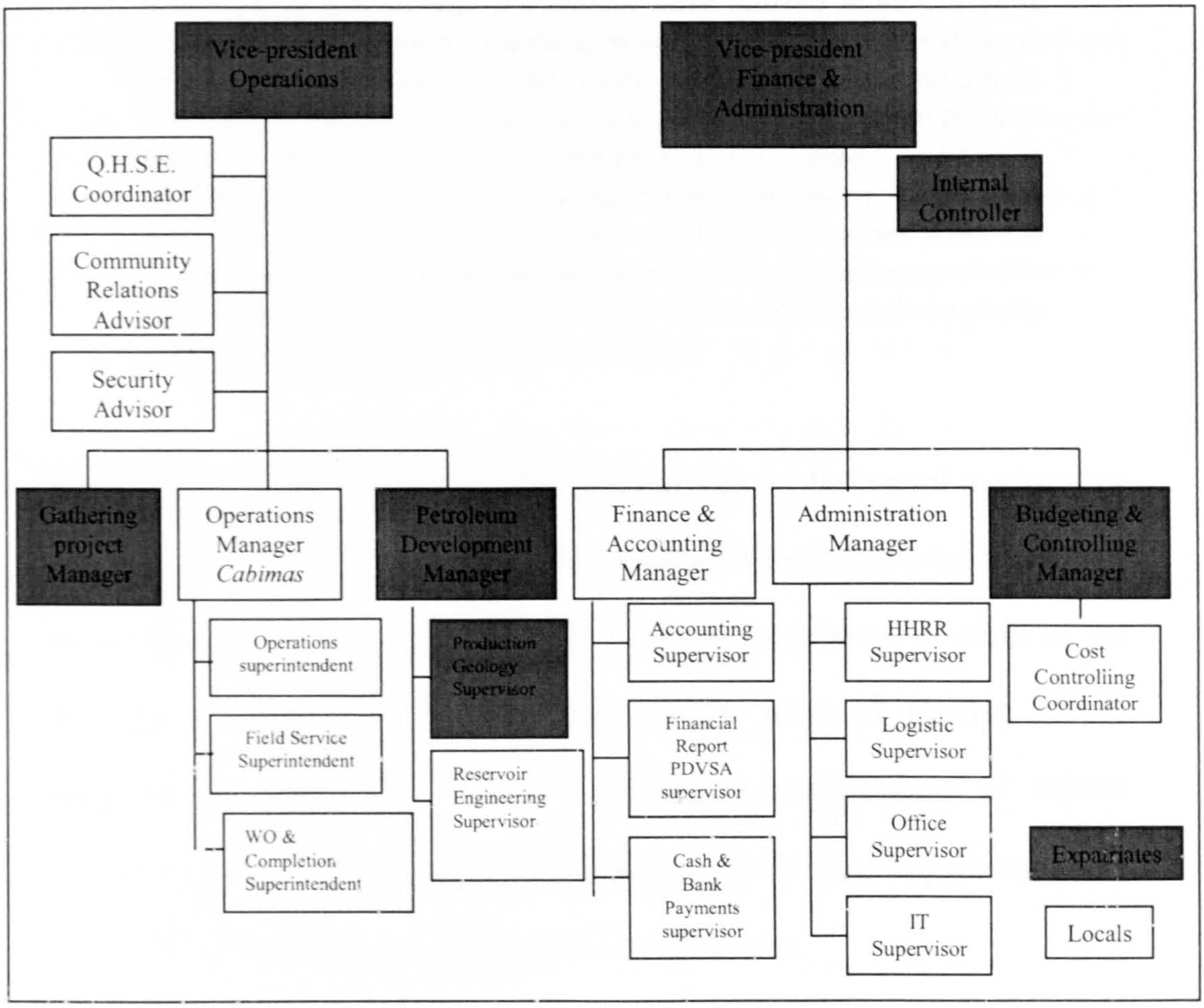
The first two years of operations of PEV were signalled by an intensive drilling campaign, which demanded the presence of many technical expatriates for periods of time between two months and one year. The goal was to increase oil production fast and to start to recover the return of the investment in three years. In 1999, the subsidiary headcount reached its peak, with 328 employees: 80 expatriates and 248 locals. The subsidiary role was a miniature replica in which the subsidiary had to develop a set of activities to support its operations and cope with the local context. These activities varied from technology for the exploration and production activities which had to be adapted to the characteristics of the *Cabimas* oilfields to activities to cope with the demands of the population of the oilfield town.

The results of the drilling campaign were not successful and large oil deposits were not found. The initial expectations of recovering the investment in 2002 started to look gloomy and the investment on the Venezuelan subsidiary was slow down. A reorganisation of operations was carried out in PEV. It reduced its workforce by 30 per cent in 1999: currently, the subsidiary has 280 employees. Figure 5.3 presents the organisational structure of PEV in 2002 and the main positions occupied by expatriates and locals.

Because of the characteristics of the local context, PEV's has been concentrated in developing capabilities to cope with it. A reduction in the investment in the subsidiary occurred, as the initial expectations of the German MNC in terms of capital recovering and levels of production were not fulfil. According to Birkinshaw typology (Birkinshaw and Hood, 1998) a parent-driven divestment on the subsidiary has occurred.

Some capabilities, which were developed locally, were not diffused to other subsidiaries or corporate offices. For instance, the creation of technical knowledge because of the incorporation of locals in the technical area that had experience in *PDVSA* and other foreign MNCs. These personnel improved internal procedures in the subsidiary, however, this knowledge was used only locally.

Figure 5.3 PEV Organisational Chart in 2002



Source: PEV HR unit.

The volatility of the local context has been one of the major reasons for the decrease in the strategic value of the subsidiary. The lack of a stable environment that support the development of plans according to the initial expectations of the oil MNC is a major factor to explain the downgrading of the subsidiary. However, the lack of international experience of Preussag Energie also plays a role on how the subsidiary coped with the local environment. The German planning and controlling manager analyses the situation as follows:

The way the business was set up and the speed of the investment were completely wrong. We should have started more carefully and with more revision, thinking more critically, not investing so much money and checking the results and maybe investing again. We came to the country investing a huge amount of money the first 2 years. We did not get the results that we wanted and this is nothing to do with Venezuela and not very much to do with PDVSA. Most of the business case and the deviations from the expectations are related with the management in Germany and to the management here in the country. The control has been pretty loose and very bad decisions were taken.

The evolution of PEV has signed the configuration of the control mechanisms in the German subsidiary. The next part presents the control devices which have been implemented in the subsidiary. We will examine them in terms of the previously identified dimensions based on the work of Harzing (1999) discussed in Chapter 1. Chapter 3 developed combinations of control mechanisms according to the country of origin of the MNCs; they are compared with the findings of the case studies in the next sections.

5.4 Output Controls in Preussag Energie Venezuela

As we referred earlier in Chapter 1 and 3, the main output controls that are studies in this thesis are financial. PEV has financial controls that are implemented to legitimise decisions and actions that have already occurred rather than to control future manager performance and outputs. There are no tight financial controls to evaluate the returns on the investment. In spite of the significant amount invested in the country, there was an initial lack of financial controls in the Venezuelan subsidiary.

Financial planning and procedures in the subsidiary have evolved over the years. In the first years, investment planning and cost control almost did not exist. The only control from corporate offices over investments was the support of the costs and expenses. The high levels of integration of German firms are reflected in the strong integration of the PEV accounting system with Preussag Energie accounting system. PEV is not an independent unit in accounting terms. Despite the decentralisation of decisions in the subsidiary, its accounts are consolidated at the end of the fiscal year with Preussag Energie corporate offices.

Preussag Energie tightened the financial controls in the subsidiary with the creation of a unit for planning and controlling. The poor financial results in the second year of operations and the demands on Preussag to increase its returns are the reasons for that. A formal process to elaborate the annual budget was implemented, which is approved by corporate offices. There is a follow-up to deviations from the budget, although its objective is not to control expenses: it is rather to learn from deviations and correct them in next round of planning activities.

In this sense, Ahrens (1997) argues that accounting practices in German firms is a process to rationalise and legitimise completed operational proposals rather than to act as a control and evaluation for future performance.

The embeddedness of Preussag Energie in the German BS is still present in the dual accounting system of PEV. The *PDVSA* reporting system follows international GAAP and differs from the reporting system of Preussag, which follows German GAAP. The subsidiary has an internal controller, who is in charge of the accounting system that reports to Germany. In the last year, 2002, a project management program has been implemented in the subsidiary aimed at making PEV more cost-efficient and more accurate in the analysis of its return on the investment.

There is a monthly reporting system from each department in terms of investment and costs. The information from the administrative area is consolidated in the subsidiary in the planning and controlling department and sent to Germany after the approval of the Vice-president for the area. In PEV there is also a dual system of reporting: two lines of report, one from operations and the other from the administrative area, which report similar information but in different format and to different departments; administration and operations. The implementation of the project management program aims to eliminate duplication in reporting, with the integration of reports in one system through standardisation. The new programme also aims to implement performance indicators in the different areas to increase efficiency in the company, adopting a more Anglo-Saxon approach in the management of the operations of the subsidiary.

The changes in the financial area were implemented following a corporate decision to increase efficiency in operations and to show results in the short term. The German manager of planning and controlling describes the changes in the financial controls in PEV:

> *Until half year ago the control was very loose, I would say that they were not so much interested in what we were doing here. Our mother company, we have to go back to the history of the company, and until 10 years ago was almost exclusively focused in Germany. Then the company decided to go abroad and they opened different branches in different countries. On one side you have the company and the management in Germany which grew up in Germany with operations in Germany and then tried to go abroad, and that was always a little bit difficult for them to handle. Sometime you got the impression that they don't know so much what is going on in the foreign countries as well they didn't want to know it...So that was until half a year ago...*

The changes in the strategy of Preussag cascades down on how the firm is controlling its operations abroad: a more Anglo-Saxon approach to the control of costs and the return of the investment is affecting the nature of the financial controls in the subsidiary. There is a process of change in the financial controls in PEV. The subsidiary has similarities with other German firms in its financial controls, however, they are under a process of change which shows a more hybrid approach in the implementation of these devices in the subsidiary.

5.5. Bureaucratic Formalised Control Mechanisms in Preussag Energie Venezuela

By contrast with what could be expected in a German firm, PEV presents low standardisation especially in the technical area. The procedures to follow in the technical area are few, particularly to guide the exploration and production activities. The small number of operations and the little experience of the company in such as activities are the major reasons for the little reliance in standardise procedures. PEV relies on individual knowledge to carry these out. The German technical experts are relocated to cover temporarily the activities abroad. Nevertheless, there are some international standards from the American Petroleum Institute and the Societal Petroleum Engineering Association for the exploitation of oil and gas that are followed by the company. After the subsidiary was set up, certain procedures in the technical area have been developed locally. There is a set of rules and procedures elaborated in the last year for the *Cabimas* field, to regulate internal operations in the field and also safety and environmental issues, which is a mix of *PDVSA* safety and environmental regulations, Preussag Energie's experience of operating this type of field in Germany and the accumulated experience of PEV of operating the *Cabimas* field.

The administrative area is more standardised. A guidebook has been developed locally, which contains explicit policies, procedures and levels of decisions for the administrative areas in the subsidiary. They have been adapted from guidelines developed in corporate offices. There has been a process of developing procedural controls in the local unit, despite the limited initial standardisation in PEV. For instance, there are periodic visits of German auditors to carry out management audits of systems and procedures and to make suggestions for improvement.

The contrast between the two areas, technical and administrative, with high levels of standardisation in the administrative area but less in the operative one, is largely explained by the lack of international experience of Preussag in exploration and production activities. As the manager for Standardization and Special Projects department expressed it:

> *We use manuals in Germany. As we are the first international operator there are no previous manuals for oilfields but we have rules from Germany, very precise rules that I also use here. For instance, I have in the project area a guide of 140 pages. I need to prepare my work following that guide.*

The tendency to standardise procedures and norms in German firms, in the case of PEV, is mediated by other factors such as the size of the MNC. In addition, the standardisation has two levels, global and local. In the case of PEV, the multinational structure of the firm does not reinforce the need to standardise on global basis, except in the areas such as finance in which more integration is required.

5.6 HR Practices and Policies in Preussag Energie Venezuela

PEV's HR function shows distinctive characteristics of the typical German personnel function described by Ferner and Varul (2000; 1999). The function has an administrative orientation. Practices like job evaluation, succession planning and management development are not implemented in the subsidiary, it has been concentrated and the administration of the pay roll. There is no involvement of the function in the decision-making of the subsidiary and there no formalisation of training, recruitment and selection activities.

The role of the department is more consultative and supporting rather than a decision-maker. This assertion is validated by the reporting line in PEV, in which the HR function is at a third level under the supervision of the administration manager, who reports to the finance and administration vice-president (see Figure 5.3). The appointment of an HR supervisor rather than an HR manager is consequence of this categorization of the function.

Communication and flows of information between the local function and the rest of the MNC are almost non-existent. The main transfer to the subsidiary has been the policies written in a "blue book" created in Germany, which has gone through significant adaptation to the local context. The book includes information on administrative activities such as level of decisions, HR policies and procedures and security activities. However, it has been implemented after four years of subsidiary operations.

The features of the host country environment support the operating nature of the HR function in the subsidiary. Granell et al. (1997) have pointed out the operating and reactive character of the personnel function in Venezuelan firms. The political instability in the country and the frequent changes in the labour regulations have forced the HR function in the indigenous firms to concentrate on the management of the relationship with unions and government entities. Therefore, the MNC subsidiaries operating in this highly regulated context have weak pressures to develop a more strategic approach. This fact is exacerbated by the lack of internationalisation of the local firms, who do not bring pressures to adopt an alternative view of the function.

In terms of the career development of employees, there are no activities to support a program of this nature, either locally or internationally. In the case of expatriates, their main roles are to act as a control mechanism or to cover a shortage of qualified people. In the case of local personnel, they were appointed to fill positions in the local subsidiary rather than to pursue an international career. The expatriates appointed to the subsidiary are located on a temporary basis and their assignment to the subsidiary is not part of a career development plan. Therefore, the absence of an international managerial career development plan does not support the development of informal networks among Preussag's units.

Regarding technical and managerial training, there is no annual planning for these activities. PEV is reactive in this matter: the only policy is regarding the number of courses that an employee can take in one year in the technical area. The managerial training is very informal. The implementation of subtle control mechanisms such as global training activities, which are designed to be attended by employees from the different subsidiaries, are missing in this case.

Concerning other practices like personnel selection, there are no criteria to support this process in terms of abilities, skills or competencies required. In addition, the activity is centralised in the hands of the vice-presidents for almost all the positions of the subsidiary, but there has not been any transfer of this practice from abroad. The German subsidiary has preferences on locals with German origins as a criterion to hire people for some jobs. The absence of a formal process to identify adequate personnel competencies is substituted for this selection criterion.

Finally, there is no formal performance evaluation program: the compensation policy merely contemplates an annual pay increase, which is not linked to individual or group performance. Regarding job descriptions, there are some of these, particularly in the administrative area; however, they respond to the need to justify positions to *PDVSA* rather than an internal control to define the outputs of the different job allocations.

5.7 Expatriate Managers and Personal Control in Preussag Energie Venezuela

PEV has a considerable presence of expatriate managers as was expected in a German MNCs. The absence of strong institutions and a legal framework to regulate the agreement between *PDVSA* and PEV make it difficult to influence the decisions levels in *PDVSA* through formal mechanisms, creating pressures on PEV to control this relationship through the expatriates.

The presence of expatriates is justified as a direct control mechanism by the volatility of the environment and the particular relationship with *PDVSA*. The German operations vice-president described the situation as follows:

We have had this experience several other times, when the general managers or members of the board of directors came to Venezuela to talk to PDVSA in Caracas. For example, to talk to executive members, it doesn't help too much. If you want to get results you have to be here all the time, to talk to them, to talk to Caracas, to negotiate with them, otherwise, you will not be able to get any results.

The complex relationship between PEV and *PDVSA* has led the German subsidiary to develop mechanisms to cope with the demands of the NOC. The German subsidiary has had to adapt to local demands and thus tried to please *PDVSA* in order to win investment approvals.

This informal network is created mainly between PEV local employees and *PDVSA* decision levels as a tactical mechanism to obtain approvals and to keep the business running. The reliance on this informal network to cope with the lack of explicit rules to be followed and the frequent changes of *PDVSA* put pressure on the expatriate managers to keep a tight rein on negotiations. Thus, the presence of expatriates was justified as a direct control mechanism made necessary by the volatility and uncertainty of the environment.

The presence of expatriates has varied in different levels of the organisation. For instance, during the peak of the drilling activities, there was a strong presence of them when the subsidiary brought many technical experts from the corporate offices to supervise this campaign. However, the reasons for expatriation in PEV are different for the managerial and technical areas. In the case of the managerial level they come for longer periods of time to support the activities of the subsidiary.

In the case of the technical area, there are two main reasons why they come to the country. First, experts with particular knowledge come for short periods of time to help on specific projects. Second, the shortfall of geologists in Venezuela forced PEV to bring a group of German geologists to the country.

There is a plan to localise the subsidiary workforce, which started with the localisation of positions like the operations manager for *Cabimas*, the finance and accounting manager and the reservoir engineer supervisor. However, the localisation has become slower in the last year because it has been difficult to find the right people for some managerial jobs. In some cases the failure to appoint the right Venezuelans has created a lack of confidence in continuing with the localisation process. Here one interesting feature of how PEV managed this difficulty is the employment of Venezuelans of German extraction. In some intangible sense, PEV trusted these Venezuelan nationals in a way in which they would not trust others, simply because of their families' German origins (which in turn could stretch back generations). The sense of a German 'community' in Venezuela, therefore, became a resource that the company could call on to reduce its feelings of independence and loss of control.

The oil MNC faces on the one hand forces to localise its workforce, because of *PDVSA* demands of a smaller number of expatriates and, secondly, there are high costs associated with expatriation, particularly in a country like Venezuela. On the other hand, it faces forces to keep a high number of expatriates because of the need to have a close eye on subsidiary operations as frequent changes in the environment need to be responded in ways that can not be carry out from abroad.

5.8 Control through Socialisation and Network Development in Preussag Energie Venezuela

Socialisation as a control mechanism is very limited in the subsidiary in contrast with what was expected. There are no corporate activities that support the socialisation of the local personnel with the rest of the MNC. However, the expatriates act in the subsidiary as an indirect mechanism of socialisation and acculturation of locals. A local manager described this process as follows:

> *If the boss says I would like to see a summary of what has been paid, he does not care about the details, he wants to see 5 lines. We are not training for that and that brings frictions. This is a cultural process difficult to understand and to integrate in the behaviour. Precision is not just in facts, time is very important for Germans, too. They are not used to work 40 hours in the week, they work 32 hours, and we have to compensate for the fact that we are not able to do all the work in 32 hours.*

In an informal way, PEV has developed mechanisms to support the acculturation. For instance, the expatriate managers have identified local candidates to substitute expatriates in certain positions. The local candidate goes through a mentoring process with the German expatriate who is in charge of the position, to learn the specifications of the job and the reporting formats of the company.

There are informal relations between the German expatriates with people in corporate offices. This relationship has been developed during the time that the expatriates have worked there. For instance, there are strong informal links between the two Vice-presidents of the subsidiary and the executive board in the corporate offices which facilitate the full decentralisation of decision-making process to the subsidiary. However, for the locals the development of this informal relationship has been more difficult. There are no formal cross-departmental relations with other areas in the MNC that support the development of this type of relationship. There is a lack of integration of them with the rest of the organisation.

The control mechanisms found in PEV show some divergence on what was expected according to hypothetical strategy of control of German firms developed in Chapter 3. They are summarised in Table 5.1.

Table 5.1 Summary of Control Mechanisms in PEV

Type of Control Mechanisms	*Control Mechanisms in German MNCs*	*PEV*
Output Control	**Low**	**Low (but in process of change)**
Bureaucratic Formalised Control	**High**	**Medium**
HR Practices and Policies	**Administrative and operative**	**Administrative and operative**
Personalised Centralised Control	**High**	**High**
Control by Socialisation and Networks		
1. Socialisation	**Medium**	**Low**
2. Informal exchange of information	**Medium**	**Low**
3. Formal lateral relations	**High**	**Low**

First, the financial controls were in process of change with a more Anglo-Saxon approach to control the financial operations of the subsidiary. In this sense, the firm is becoming detached from the traditional way to control financial operations in German firms. Second, the levels of standardisation that were expected in the technical area were fewer according to the tendency in German firms. However, the tendency is to move to standards on procedures, particularly in the administrative area. It can be argued that the process of development of the subsidiary has influenced in the implementation of this type of devices. Finally, there is little reliance on cross-departmental relation to support the presence of control by socialisation and networks which differs to what was expected. However, the characteristics of the sector and the organizational structure of the firm can be an important explanation of the differences found in the case study and the expectations according to the country of origin of the firm. As we can be seen from the analysis of the control mechanisms in the German subsidiary, the country of origin is an important explanation to the control mechanisms found in the subsidiary. However, there are other variables that influence the existence of these devices as this case shows. In the next part, we discuss the British oil subsidiary: Lasmo Venezuela and the nature of its control devices.

5.9 LASMO

Lasmo is a middle-sized independent company from the oil and gas sector, concentrating on exploration and production activities. Its corporate offices are in London, and the company employs approximately 750 people globally. The company was founded in 1971 as a venture capital company, which participated with funds to explore for oil and gas in the new oil market in the North Sea, following high-expected returns from oil exploration activities. During this decade oil prices rose and small oil companies invested in exploration activities looking for high returns in the production phase.

Lasmo's internationalisation process started in 1982, almost ten years earlier compared with Preussag Energie. The company decided to go abroad due to low returns on the investment in the North Sea. It started its internationalisation with the acquisition of a Canadian oil firm and followed the same pattern in the following years. The firm also obtained licenses for the exploration of oil in low-cost regions and worked as a contractor for NOCs to carry out exploration and production activities and have a further internationalisation. This mode of internationalisation shaped the relationship of the corporate offices with the subsidiaries. As the finance and tax director of Lasmo describes:

> *Lasmo tends to give a high level of autonomy to the subsidiaries. For instance, they should maintain or improve the relationship with governments or national oil companies. So their responsibility is to keep this local relationship and not that with the head offices. In this sense, the head offices' role is to assist the subsidiary to fulfil this objective.*

The fact that Lasmo is not integrated downstream also supports the operation of the company with a multidomestic structure, with independent subsidiaries in each country. Lasmo had experienced an accelerated internationalisation in the '90s following a strategy to grow in size. By 1993, the United Kingdom region, consisting of the UK Continental Shelf, the Netherlands North Sea and the Irish

Sea contained 52 per cent of the group reserves: of the remaining reserves 40 per cent were in Indonesia, and 8 per cent in the rest of the world, in countries such as Algeria, Colombia, Italy, Libya, Pakistan, Yemen and Vietnam (LASMO, 1993). In 1999, this distribution of the reserves changed, with 21 per cent of the reserves in the United Kingdom, 19 per cent in Indonesia and 60 per cent in other countries such as Venezuela, Pakistan, Algeria, Libya and Turkmenistan (LASMO, 2000).

This redistribution of the reserves of Lasmo was driven by the adoption of a new strategy. In the search for high financial returns in a market with an increasing volatility in prices, Lasmo decided to concentrate on regions where it was possible to produce oil at low cost. This strategy led it to invest in places with a large amount of hydrocarbon reserves with low technical risk and attractive cost structures. These areas had low production costs and also offered opportunities to increase production in the long term, which made it competitive to produce even with low oil prices. The majority of regions with these characteristics were onshore basins in developing countries such as Venezuela, Indonesia, North Africa and the Middle East, and the Caspian region.

Lasmo also looked for other ways to have more control of its cost structure, deciding to be more active in the operations of the field. Lasmo, similar to Preussag Energie, was an investor, while other oil firms operated the fields. Lasmo had little control over costs, development of the projects, budgets or financial planning under this scheme. The MNC, then, sought for opportunities in which it could control the entire operation of exploration and production of oil. The changes in the strategy of Lasmo reveal a strong need to generate results in the short term. The composition of the ownership structure, which has a strong Anglo-Saxon flavour, played an important role in the need to pursue this objective.

5.9.1 Lasmo Ownership Structure

Lasmo has been a public company since it was founded. Following an Anglo-Saxon pattern, its initial investors were institutional investors from the United Kingdom. In its process of consolidation, Lasmo continued to obtain funding on Anglo-Saxon markets. It is listed on the London and New York stock markets, raising funds to expand its operations of over $600 millions on the US capital markets (LASMO, 1993). The shareholder structure of Lasmo is composed of 88.57 per cent in the hands of institutional investors; and 11.43 per cent is held by individuals, who are mainly the directors of the MNC (LASMO, 1999). As a result of this, the firm is driven by a strong commitment to be attractive to Anglo-Saxon shareholders. The Board of directors of Lasmo is a mixed composition between executive and independent directors. The majority of them have experience in the oil industry. Some of them became directors after some of Lasmo's acquisitions of other smaller oil companies, and others came from larger oil MNCs such as BP Shell (LASMO, 1999).

The character of oil, which is a commodity product, makes it difficult to compete by differentiating the product of the firm. The competition among firms in the sector is based on the size of the reserves and on the reduction of the cost to produce the oil. The strategy of Lasmo has been to move to low cost areas as part of its strong drive to maximise shareholder value. The Anglo-Saxon influence in the MNC is also observed in a number of internal reorganisations and the divestiture of non-profitable fields, following the pattern developed by the larger MNCs in the sector after the fall of the oil prices in the '90s. In 1993, the company carried out a reduction of its overheads of 21 per cent, and a number of disposals of low production fields. Other operations fields were sold in the next years, and in 1999 the firm decided to concentrate its operations in seven regions: UK, Indonesia, Venezuela, North Africa, Pakistan, the Caspian Region and the Middle East.

In 1998, the multinational organisational structure was reinforced, with more autonomy given to the subsidiaries while retaining essential controls at the corporate centre. This further decentralisation came together with a reduction of its personnel in London by 55 per cent (LASMO, 1998). The pressures from shareholders to maximise returns is reflected in the great emphasis on cost reduction, profitability and efficiency in the statements of Lasmo. The Chairman of the firm described in 1997 the strategy of the company:

> *Lasmo's principal objective remains to maximise shareholder value...our strategy for delivering growth in shareholder value is based primarily upon successful exploration for, and production of, hydrocarbons. We will access opportunities by direct negotiation, competitive bidding, through license rounds and by*

> *acquisitions. In our view, the highest returns can be achieved through successful exploration and therefore we shall look for new investment opportunities, which offer this, potential.*

This emphasis on short-term results in the Anglo-Saxon MNCs is also observed in the financial systems developed in Lasmo, with elaborate systems of control and tight financial controls.

5.10 Lasmo Venezuela

In 1997, Lasmo entered the third round of the Venezuelan opening, winning the contract to explore and to exploit the *"Dación"* area in the eastern region of the country. Venezuelan oil opening looked very attractive to many oil companies that were searching for new oil basins in low cost environments. In the case of Lasmo, Venezuela fitted its strategy to invest in low cost environments, and also the intention of Lasmo to become an operator. Lasmo obtained a twenty-year contract to explore and to extract the oil in the area: the oil wells for production activities were already built and the company had to continue with the oil production and achieve the production quota fixed by *PDVSA*.

The type of investment carried out by Lasmo in Venezuela shows a more risk-taking strategy typical of Anglo-Saxon firms compared with Preussag Energie. Venezuela was the largest Lasmo investment abroad and it represented the highest bid in Venezuela's third marginal round (Oil and Gas Journal, 1997). By contrast with Preussag Energie, which made the lowest bid of the third round for its concession. The oil MNC, to overcome its weakness as an operator, established a strategic alliance with Schlumberger, an international engineering company with long experience in the country in oil exploitation.

This alliance aimed for support for its exploration activities, and technical support in the development of the field.

Lasmo sent a cadre of expatriate managers to manage the operation in Venezuela: the best people that Lasmo had were sent to the country. In 1997, Lasmo had 120 expatriates to start up the subsidiary. Similar to PEV and following a multinational organisational structure, Lasmo Venezuela was managed as a part of a portfolio of independent businesses. The expatriates, who came to the country, were at two levels: managerial and technical. The expatriate team at managerial level had great autonomy from corporate offices to organise the work in the subsidiary, design procedures and negotiate with *PDVSA*. However, this level of autonomy delegated to expatriates went together with an informal network between the president of the subsidiary and the board of Lasmo. A senior economist in the subsidiary expressed his power of influence in London in this way:

> *The president of the company* (Lasmo Venezuela) *here is a quite a strong wheel, they are very confident in what he does and he does things. So, he has a certain management style and relationship with the CEO of the company. The president here has a very strong relationship, very strong wheels. So, I think he is an able to have more room to do what he wants.*

The pressures under which Lasmo had to reach a fixed production level in six months explain the large presence of expatriates in the technical area. The company did not have time to look for local people and had to bring its own experts. PEV by contrast tried to appoint local people from the beginning but it could not find a well-trained local workforce. In the next sub-section, it is described how the characteristics of *PDVSA* and its relationship with Lasmo shaped the subsidiary configuration.

5.10.1 Lasmo Venezuela Market Positioning

Lasmo Venezuela is exposed to the same structure of the industry in Venezuela as PEV. The concession of the field has been under the same scheme, creating similar problems for the British subsidiary in the management of the relationship with *PDVSA*.

Lasmo has found it very difficult to manage the relationship with *PDVSA*. After the third round of concessions political changes have occurred in the country, which have been reflected in the management of the NOC. The difficulties of managing the relationship with *PDVSA* were put in this way by the field developing planning manager of the subsidiary:

> *We still don't understand PDVSA as an organisation. We still don't understand what motivates them. Why we get requests, when those requests come, what we should be doing. So, I think enough effort is putting in to understand PDVSA. What we should do is to be sure that PDVSA gets what it wants.*

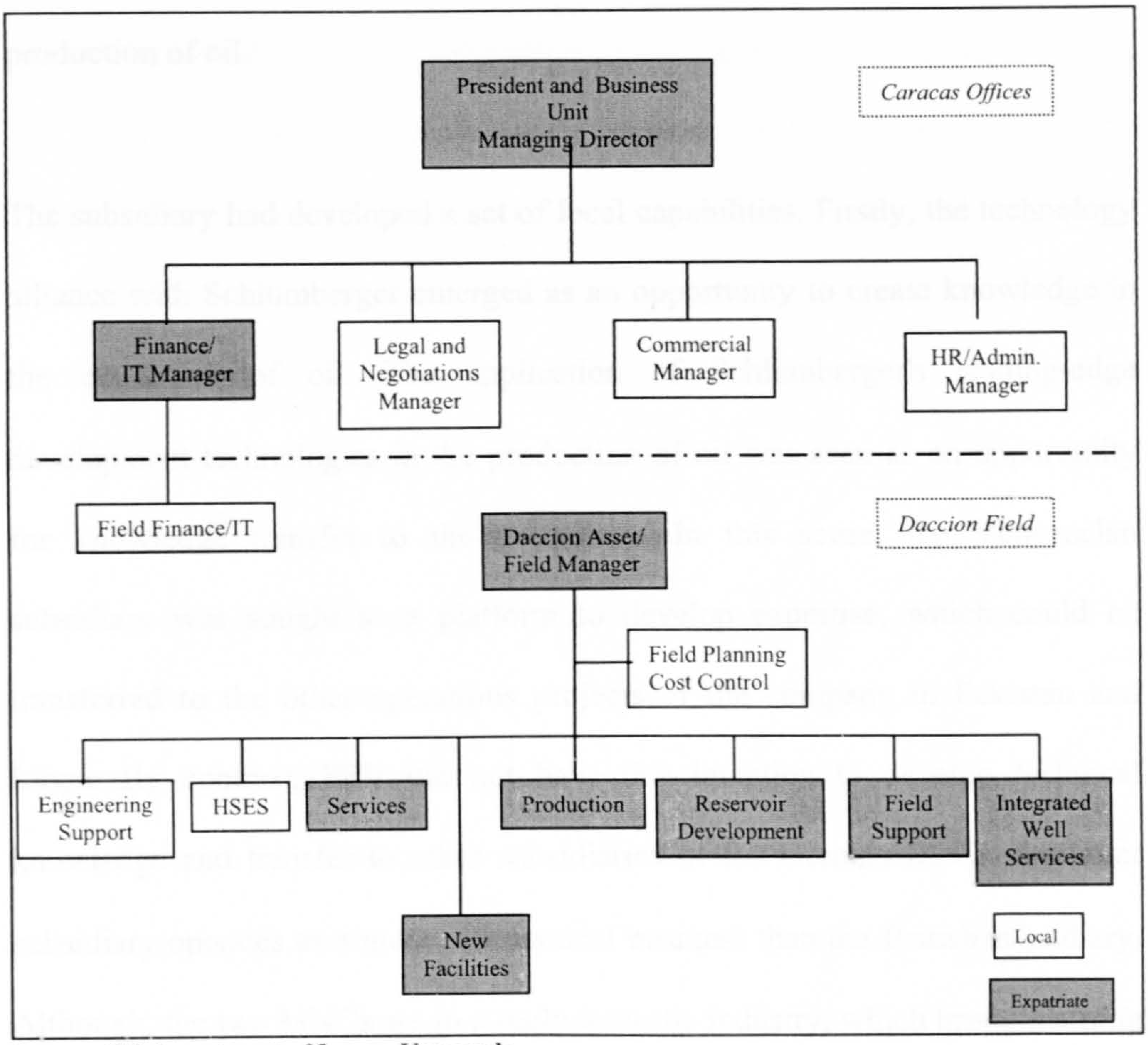
The demands of *PDVSA* in terms of reports change frequently. In addition, the periods for approvals on the investments of Lasmo takes more time than was set initially. As in the case of PEV, the position of Lasmo to negotiate is weak: the strong bargaining power of *PDVSA* is one of the major reasons for this. An investment of the size of Lasmo in the country, together with the strong pressures from shareholders to obtain profits in the short-term, creates a difficult situation for the MNC. As the multinational organisational structure does not support a careful supervision from the corporate offices, the expatriates play an important role in the follow-up of the operations of the subsidiary.

The subsidiary during its operations has developed a number of capabilities, which could sustain the initial strategy of the subsidiary or modify it. The next part discusses the strategy of Lasmo Venezuela, its development of capabilities and its value for the MNC.

5.10.2 Evolution of Lasmo Venezuela and Development of Capabilities

A great deal of financial and human resources were assigned to Lasmo Venezuela, which implied the transfer of knowledge from abroad. In the initial stages, the subsidiary was an implementer, which adapted imported resources to the local situation. The subsidiary had an important value for the expansion strategy of the MNC mainly for similar reasons to PEV. Firstly, the Venezuela subsidiary was the first initiative of Lasmo as an operator of oilfields. A technology transfer, was expected, from the alliance with Schlumberger. Secondly, the MNC had expectations to move to other related business in the country, such as gas and to win other oil concessions in Venezuela. The subsidiary after 4 years has 279 employees and still has a presence of expatriate managers, as Figure 5.4 shows.

Figure 5.4 Lasmo Organisational Chart in 2001



Source: HR department of Lasmo Venezuela.

However, looking at the evolution of the subsidiary and its place in the business portfolio of LASMO, the investment in the Venezuela subsidiary has been reduced slightly. Lasmo reduced its investment in exploration and production activities in 1998 in all subsidiaries because of the cheap oil price (LASMO, 1998). However, the levels of oil production in the country were increasing and the subsidiary was working in the reduction of costs in 1999. As the investment of the MNC in the country has a strong economic value because of the size of it, the MNC has to show profitability in this investment. The shareholders follow with great attention the development of this investment in terms of the production of oil.

The subsidiary had developed a set of local capabilities. Firstly, the technology alliance with Schlumberger emerged as an opportunity to create knowledge in the extraction of oil. The application of Schlumberger's leading-edge development technologies in the production of oil was seen as an opportunity for knowledge transfer to the subsidiary. In this sense, the Venezuelan subsidiary was sought as a platform to develop expertise, which could be transferred to the other operations projects of the company in Pakistan and Libya. By contrast, PEV did not have this intention to develop technical knowledge and transfer to other subsidiaries of the German MNC: the latter subsidiary operates as a more independent business than the British subsidiary. Although, the two MNCs are in a multidomestic industry, which brought strong demands to localise and adapt to local circumstances, the type of technical activities carried out in them can be integrated to the rest of the MNC. However, the two subsidiaries show different patterns in this matter.

The subsidiary is in the process of development of another capability, which is more local in its nature. Lasmo is a very flat organisation, working with *PDVSA*, which is a hierarchical and centralised organisation. A very valuable capability that the subsidiary has had to develop is to learn how to handle the relationship with *PDVSA* because of its need to obtain the approval for investments quickly, and to negotiate the production levels of the subsidiary.

By contrast with PEV, the company has not developed an informal network to communicate with *PDVSA*. It has used the formal channels to negotiate with the NOC and it has looked for expert advice on how handles this relationship. In the next section, there is a more detailed review on this matter. The control mechanisms in Lasmo Venezuela are presented in the next part following the typology presented in Chapter 1.

5.11 Output Controls in Lasmo Venezuela

There is a strong reliance on financial mechanisms to control the operations of the subsidiary in Venezuela as can be expected according to the country of origin of Lasmo. There are many activities carried out in the subsidiary to control financial operations. For instance, there is strong emphasis on the elaboration of budgets to control costs. Every department has to elaborate its budget annually with specifications regarding the activities carried out. This budget is presented to corporate offices for approval. A special emphasis is given to the field development plan to estimate the amount of the investment associated with the oil production activities. Lasmo Venezuela compared with PEV makes a different use of this practice. In the case of Lasmo it is a practice to negotiate with corporate offices, targets and the profitability of the next period. In the case of PEV it is more an internal practice to follow up current operations. The influence of the country of origin can be seen in the two cases.

There is a set of monthly reports to corporate offices, such as finance ratios regarding the return of the investment, production and administrative costs, finance statements, production, investment and security reports, and headcount and personnel costs. As Lasmo is listed on Anglo-Saxon stock markets, the follow-up of profits on a quarterly basis is important. This attention to the generation of profits is reflected in the production of reports to forecast and check the production levels and compare them with the field development plan built up at the beginning of the year. There is also a living plan of reserves and production levels for the next 5 years, which is elaborated quarterly. The estimates of this plan have implications for the price of the share of the MNC because they reflect the potential of the MNC to produce oil.

There are different reports and plans, which the subsidiary has to send to corporate offices frequently. In the elaboration of the budget a management team integrating by the president of the subsidiary, the commercial manager, the operations manager, finance manager and human resource manager was created to set the goals of the subsidiary. In addition, there is a negotiation process between the subsidiary management and corporate offices for approval of budget. This is a common practice of British firms, which negotiate targets rather than impose them (Vitols, Casper, et al., 1997). In the particular case of Lasmo, the use of this organisational practice responds to a combination of factors. First, there is a tendency in Anglo-Saxon firms to negotiate targets rather than impose them. Second, the expatriate managers designated to key positions in the Venezuelan subsidiary, such as the president, the HR and finance managers, are all trusted by corporate offices. Therefore, delegation to this level was easy, and in turn facilitates the budget bargaining process between the Venezuelan subsidiary and Lasmo corporate offices.

The strong financial controls are also reflected in the need for further approval for corporate offices when there is an additional investment that was not presented in the budget. This is because of its impact on the short-term financial performance of Lasmo, which influences the price of the share.

5.12 Bureaucratic Formalised Control Mechanisms in Lasmo Venezuela

Similar to the case of PEV, Lasmo Venezuela has few standard mechanisms in the technical area. The infant stage of production activities in the MNC is evident in the absence of these devices in the technical departments. However, there is some evidence of standardisation in areas such as the Health, Safety, Environment and Security (HSES) aspects, standardisation which has followed international industry best practices.

As the subsidiary is still learning the management of oilfields; thus, there has not been enough time to standardise the knowledge acquired from these activities. A Lasmo oilfield engineer compares the standardisation in Lasmo to other MNCs:

> *I think the technical procedures in other subsidiaries* (of Lasmo) *are very similar. Lasmo is a company if I compare with Shell in which I worked before that tends to adapt to the requirements and standards in each country and works based on this adaptation. By contrast, Shell has the same standards all over the world.*

In the financial area, there is global standardisation on procedures, norms and reporting activities. Lasmo needs to present public information on the performance of the firm, and the nature of its ownership structure creates pressures in the MNC to have an integrated financial reporting system. There are written manuals with procedures, reports and explicit financial calculations for investment projects. The other level of standardisation in the administrative area is more local: there is an on-line internal management system only for the subsidiary, which contains documentation for procedures in the administrative departments. The standardisation in Lasmo, particularly in the administrative area, is considerable; a typical pattern of control in British firms.

Other areas such as the HR department are heavily standardised. However, the standardisation is on a local basis rather than global. HR policies and procedures regarding benefits, training, and localisation plan for expatriates and discipline and security policies are explicit. The multinational structure of the MNC, with a decentralisation of activities in the subsidiaries, does not support a more global standardisation. This local standardisation is also part of the evolutionary process of the subsidiary that, since the establishment of the operations, looks to have internal organisation and to give cohesion to the group.

5.13 HR Practices and Policies in Lasmo Venezuela

The Lasmo subsidiary in Venezuela has implemented HR practices designed abroad. The function in the subsidiary has a strategic role, implementing innovative practices in the area. Compared with the HR function in PEV, the function in Lasmo Venezuela is less reactive, and aligns the practices of the area with the strategy of the MNC, which is characteristic of the function in British and American MNCs.

Some examples of a more strategic orientation of the HR function in Lasmo are in the area of compensation. For instance, there is a stock option program, a typical Anglo-Saxon incentive, to align performance expectations from top management with shareholders' interests. The program includes all the employees of the subsidiary and is linked to performance. The stock option program has a medium-term horizon because in three years the employees of the subsidiary can sell the shares. However, it has been subject to adaptation to please the preferences of local managers. The volatility of the Venezuela economy has shaped Venezuelan managers' preferences for short-term incentives such as a cash bonus. Lasmo Venezuela had to add a cash bonus (10 per cent of the salary) as another incentive linked to the performance of the employees.

The HR function of the British oil MNC is more integrated compared to its German counterpart. A group incentive program linked to the goals of the subsidiary has been developed locally and has been transferred to other offices of the MNC. Lasmo has a set of incentives to align the performance of individuals with the goals of the MNC. However, there is a country of operation effect, which is reflected in the preferences of local managers for short-term benefits (cash bonus) rather than long-term benefits, which creates strains for the implementation of this practice in the subsidiary and demands adaptation of it.

Lasmo Venezuela shows formalisation in its training activities and a more strategic approach to the activity. There is a set of training courses in Venezuela designed to develop managerial and language skills in locals and expatriates. In addition, there is an annual planning activity to identify the training needs of the personnel in the subsidiary and to offer courses to improve the skills and the knowledge of the employees of the subsidiary. The technical training can be in Venezuela or abroad. However, it does not support integration with other employees in the MNC because they are not in-house courses.

The selection process of the local employees is more elaborate compared to its German counterpart and even compared to the business software units. There are clear criteria on the background of the local people to occupy managerial positions. First, people with studies abroad or an MBA from a Venezuelan institution. Second, young people who can be acculturated in the company way of doing things. Third, people with work experience in other foreign MNCs in the country and preferably not coming from *PDVSA*. In the selection of the local candidate there is the participation of different levels of the organisation. For instance, there is a round of interviews with the HR department, if this is the case, with the expatriate to be substituted, the potential boss and a technical expert. In the case of a senior local position, the local has to go to London for a set of interviews there. The formality of the recruitment and selection process helps to choose the candidates, who adapt better to the organisational culture.

In the case of the expatriates the process is not so formal: the main criteria for the selection of the candidate is first, how long they have been working for the MNC, second, their expertise in the area, and third the willingness of the employee to come to the country. An incentive to take the assignment, particularly for the technical area, is the existence of an international career program of assignments for 2-4 years.

Lasmo Venezuela compared to PEV shows a completely different picture regarding HR practices and policies. The area has a more strategic approach to different activities and there is more alignment compared with PEV between the activities of the area and the strategy of the company.

5.14 Expatriate Managers and Personal Control in Lasmo Venezuela

As has been discussed, Lasmo Venezuela has high levels of autonomy from corporate offices. However, there is still a presence of expatriates at managerial and technical levels as Figure 5.4 presents. The managers interviewed at different levels of the organization unanimously claimed that there was a high degree of autonomy at subsidiary level. A Canadian economist described the relationship between the subsidiary and the corporate offices in this way:

> *London usually doesn't get involved in most decisions. If I need to check with somebody I check with the president* (Venezuela subsidiary)*: very little is what London gets involved. Only in a few*

instances where there is very important and they are interested in what is going on and they want know what you are doing.

In the technical areas, there was also high autonomy, as described by a geologist interviewed:

...the offices here work very independently. Occasionally we have visits from technical leaders from London to review things, but not very often, maybe two or three times a year.

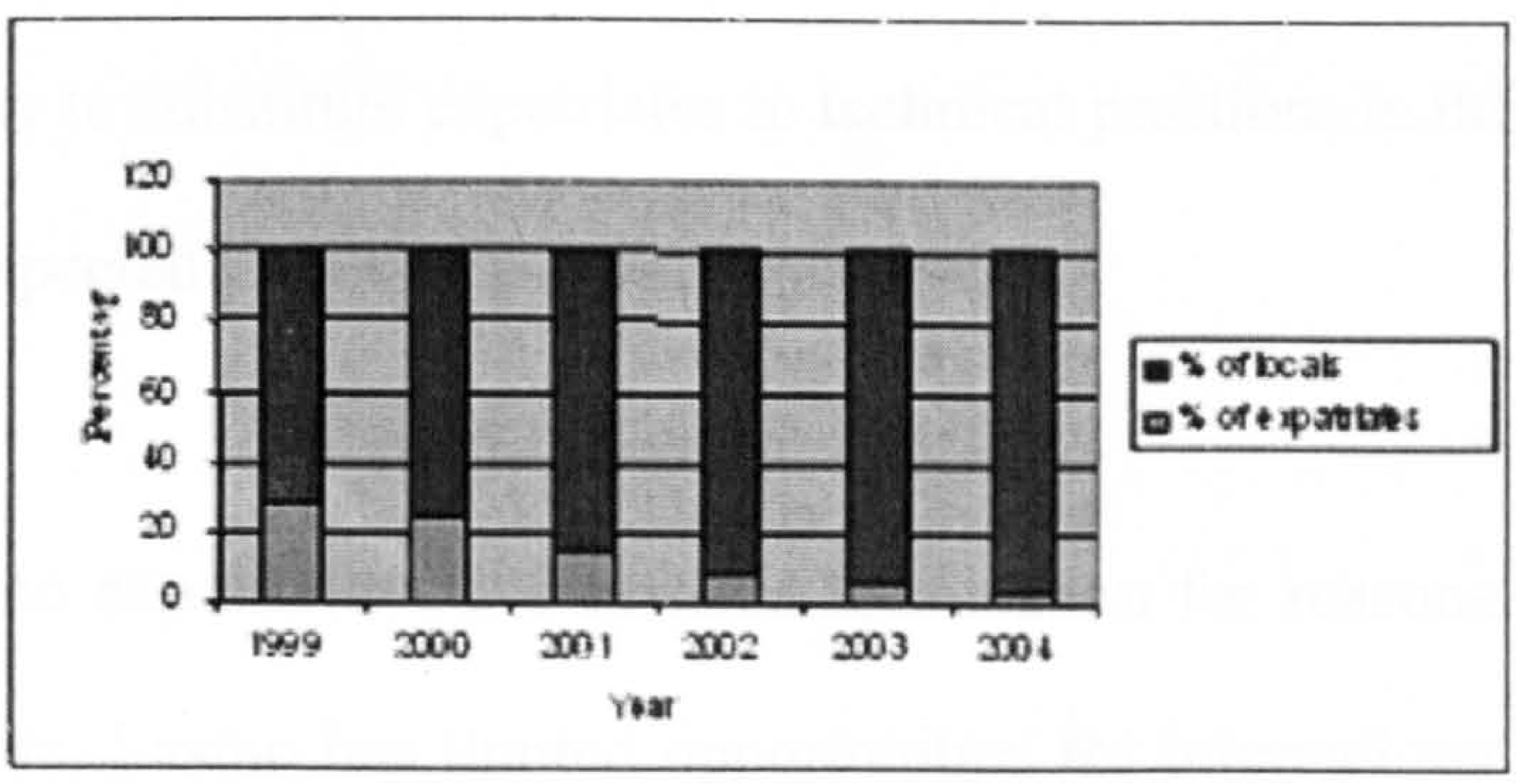
A local human resource manager expressed the autonomy in his area as follows:

If I compare the company with other companies where I have been you can find here much more freedom. In other words, I think the control that HQ offices have over this subsidiary is very little: mainly it is a reporting relation with them.

Despite the high decentralisation in Lasmo, there are some decisions that still have to be consulted over with corporate offices, particularly the use of additional financial resources, which can affect the returns in the short-term. For instance, headcount increases need authorisation from corporate offices in the cases that they have not been included in the budget. This is consistent with the tendency in British firms to have a close monitoring of personnel costs against the budget, and authorisation is required when there are additional increases. There are other forms of direct control, such as a performance review meeting with an executive director who comes from corporate offices, and the subsidiary management team follow up the progress of the planned activities. Sometimes this review is done in the corporate offices in the presence of the board of directors. This activity is carried out every quarter. Finally, a manager from the board of directors, who is part of the Venezuelan management team, travels every month to the subsidiary to review its operations.

Expatriates, since the subsidiary started operations, have occupied top technical and managerial positions. There has been a gradual localisation of positions such as HR, information technology (IT) and legal managers. However, the president and the finance manager are still expatriates. In the technical area there is an important presence of these people. The subsidiary developed a localisation plan for its workforce. In its first year of operation, 1997, 54 per cent of the subsidiary employees were expatriates; in the following year the figure fell to 35 per cent, and the subsidiary aims to reduce it further, as illustrated in Figure 5.4.

Figure 5.5 Lasmo Venezuela workforce localisation plan



Source: LASMO's HR department.

Lasmo Venezuela is under strong pressure to localise its workforce. As in the case of PEV, *PDVSA* is putting pressure on the company to increase the number of local employees, particularly in senior management positions. Venezuelan labour regulations limit the number of expatriates in national operations to 10 per cent of the total subsidiary workforce. In principle, the head office of the company would also like to reduce expatriate numbers, not least due to the high costs associated with the presence of them.

In spite of all this, however, localisation has had a slow pace in the subsidiary and has been much slower than initially planned. Three reasons account for this. Firstly, the shortfall of trained people has slowed down the process of expatriate substitution. Venezuelan graduates with qualifications in technical areas such as geology and geophysics are small in numbers, as the education system is not well developed to produce such individuals. Those who do have such qualifications are consequently in great demand in Venezuela because of the entry of the oil MNCs after the opening. It is therefore a highly competitive market for smaller oil companies such as Lasmo that find it difficult to compete with larger, more international companies. As a result, Lasmo Venezuela has found it not easy to substitute expatriates in technical positions in the subsidiary as quickly as expected.

Secondly, Lasmo expatriates have resisted localisation for reasons to do with their own careers. Lasmo has limited opportunities for international managers. For any manager moved from Venezuela due to localisation initiatives, there were no obvious places for him to continue an international career in Lasmo. The best they might hope for would be relocation back to Britain, but this would in turn lead to all the well-known problems of repatriation in an organization that was not used to this process. Therefore, expatriates were tacitly resistant to the localisation. This fact is reinforced by the absence of long-term contracts in Lasmo, characteristic of British firms and discussed in Chapter 3. The background of the expatriates shows high mobility among oil firms. This particular outlook of the expatriates in the British firm in contrast to the view of the German expatriates in PEV, who were expecting a smooth repatriation process back into the positions in Preussag Energie in Germany.

Thirdly, there are substantial difficulties in managing the relationship with the NOC. The dual roles of *PDVSA* as a monopolistic buyer of Lasmo oil production, and as investor in the facilities that Lasmo is building makes this relationship very complex. Lasmo has found it difficult to manage this relation with *PDVSA*, not just because of the power imbalance but also because of the uncertainty involved. This uncertainty is reflected in the changeable demands of the NOC in terms of reports to Lasmo Venezuela. The strategy of the MNC has been to left expatriates in charge of the relationship. However, a local manager accounts as one of the major problem this strategy:

> *I believe that part of the difficulties with PDVSA has to be with the fact that Lasmo does not select people with the same hierarchical level to the counterpart in PDVSA... Other factor is that expatriates manage many of the relationships with PDVSA. I consider that if the relationship would be in local hands, the outcome would be different.*

As was stated in Chapter 3, the characteristics of the Venezuelan context make it very difficult for economic actors to understand how the system works. So, relationships and personal networks are a very valuable asset. The weak institutional structure of Venezuela means that the institutional framework has to be substituted for personal ties. Therefore, if the link with *PDVSA* is to be managed properly, the implication is that it should be by people who have access to the personal and political networks which are the only way to obtain information and approval in a context such as Venezuela.

It has been difficult for Lasmo Venezuela to adapt to this way of operating. The localisation programme has come to a halt in a way which is not consonant with traditional models of how British MNCs evolve. PEV, compared to Lasmo Venezuela, has found a better way to manage the relationship with *PDVSA*, using locals to communicate with the NOC and developing informal networks with different actors, which can help the German subsidiary to communicate with the NOC. However, all these activities are under the close supervision of expatriates in key positions in the German subsidiary.

5.15 Control through Socialisation and Network Development in Lasmo Venezuela

Lasmo Venezuela does not present numerous mechanisms under this classification. Mechanisms to support socialisation such as the creation of an organisational vision and mission do not exist. In addition, there are no corporate meetings, which facilitate the socialisation of the member of the firms. However, there is socialisation due to the presence of expatriates, which in an informal way acculturates the locals. This affirmation is supported by the common perception gathered in the interviews from the locals of working for a British company rather than a local firm.

Informal exchange of information occurs between the expatriates and personnel in the corporate offices, and other subsidiaries as a consequence of the time that they have spent in these sites. However, for the local personnel it is more difficult. The lack of integration of the subsidiary with the rest of the MNC accounts for fewer possibilities for locals to develop this type of connection. For instance, there are some peer review meetings in certain technical areas such as geophysics and geologists but their frequency is once a year, which is very low to develop informal networks. In addition, the IT platform in the subsidiary is mainly local, in which much information is for the personnel of the subsidiary. Only after 4 years of operations, did Lasmo Venezuela and the corporate offices share the same e-mail system. This has reinforced the multinational nature of the operations in the oil firm.

There are some attempts to develop formalised lateral or cross-departmental relations. There are technical meetings with personnel from corporate offices or other subsidiaries to exchange information, with a frequency of 2-3 times a year. There are other projects, for instance in the finance area, with other subsidiaries to support the implementation of systems and programs.

In the case of Lasmo Venezuela the implementation of subtle mechanisms through socialisation and network development is very limited. The small size of the MNC is the main reason for this. However, this fact is reinforced by the multidomestic nature of the industry, which is reflected in the organisational structure adopted by the MNC.

In sum, the implementation of control mechanisms in the Lasmo subsidiary does not follow a strategic control pattern shape only by the country of origin of the MNC, table 5.2 presents the summary of the control mechanisms found in Lasmo.

Table 5.2 Summary of the Control Mechanisms in Lasmo Venezuela

Type of Control Mechanisms	*Control Mechanisms in British MNCs*	*Lasmo Venezuela*
Output Control	**High**	**High**
Bureaucratic Formalised Control	**High**	**Medium**
HR Practices and Policies	**Strategic and global**	**Strategic**
Personalised Centralised Control	**Low**	**Medium**
Control by Socialisation and Networks		
1. Socialisation	**Medium**	**Medium**
2. Informal exchange of information	**Low**	**Low**
3. Formal lateral relations	**High**	**Low**

There are differences in the nature of these mechanisms which can be explained by other variables such as the size of the company and the organizational structure. The former explains the little standardisation in the technical area and the latter the few formal lateral relations. An important factor, which was also a major source of explanation for PEV, is the characteristics of the country of operations. In the case of Lasmo Venezuela, this feature has a direct impact in the presence of expatriate managers in the subsidiary. The country of operations seems to be an important shaper of the evolution of the subsidiary and consequently has an impact in the implementation of control mechanisms in the local unit.

5.16 Conclusions

There are some points that are important to highlight regarding the configuration of control mechanisms in the two subsidiaries. First, the country of origin is a strong influence which explains the existence of several control devices in MNCs. In spite of the internationalisation of firms, the country of origin is an important factor that shapes the behaviour of firms. In the case of the two oil subsidiaries, it was identified an Anglo-Saxon effect on one hand and a German effect on the other. The influence of these effects was explained in Chapter 3 and the case studies validate some of the propositions developed in this chapter. The distinctiveness of these effects was seen in some of the behaviours of the MNCs. For instance, Preussag Energie shows a typical German pattern in its internationalisation, which is different from the international pattern followed by Lasmo. Another example is the long-term employment relationship between the expatriates and Preussag compared to the relationship of Lasmo expatriates. Finally, the financial controls are different in the oil subsidiaries, in spite of the gradual adoption of a more Anglo-Saxon pattern in the case of the financial controls in PEV. It is important to stress the fact that the adoption of other practices such as the incorporation of new financial controls in the case of PEV can be the consequence of changes in the institutions of the country of origin. These changes may be permitting the introduction of these new practices in the MNCs. The comparison of the four cases in Chapter 7 will shed more light on this point.

Secondly, other variables from other level of analysis are explanations for the differences found in the control strategies according to the country of origin of the MNCs. As was presented in Chapter 1, the configuration of these devices is a complex phenomenon that requires the integration of different perspectives to be fully understood. Features from the type of industry and the organization itself have to coexist with the influence of the country of origin shaping the actions of firms. For instance, the multidomestic nature of the upstream oil reinforces the multinational structure of the two MNCs and does not create strong demands to integrate operations. Therefore, there are few incentives to create control mechanisms based on socialisation and the development of networks.

Third, the country of operations is another factor that affects the implementation of control devices in the subsidiary. In the particular case of the oil subsidiaries, it has a strong effect on their evolution and operations. The oil industry in Venezuela in a context characterised by weak institutions and little regulation of the transactions among economic actors have shaped the evolution of the subsidiaries and the development of their capabilities. Its influence is not only limited to the implementation of control mechanisms. The characteristics of the local context have driven the subsidiaries to concentrate efforts to cope with the local environment. In this process, the type of capabilities developed may has not strategic value for the MNC. In some cases affecting the role of the subsidiary in the business portfolio of the firm such as is the case of PEV. In addition, its effect is also seen in the slow localisation of the workforce in the

MNC subsidiaries. The presence of expatriates as a direct control mechanism is largely explained by the characteristics of the country of operations of the subsidiaries, which make difficult their substitution by other modes of control.

In the next chapter, we present the cases of the subsidiaries from the business software industry. The comparison of the cases follows the same structure that is presented in this chapter. After the comparison of the next industry, Chapter 7 will present the final analysis of the main similarities and differences found in the four cases.

Chapter 6: The Business Software MNC Subsidiaries: SAP for the Andean Region and the Caribbean and Baan Venezuela

6.1. Introduction

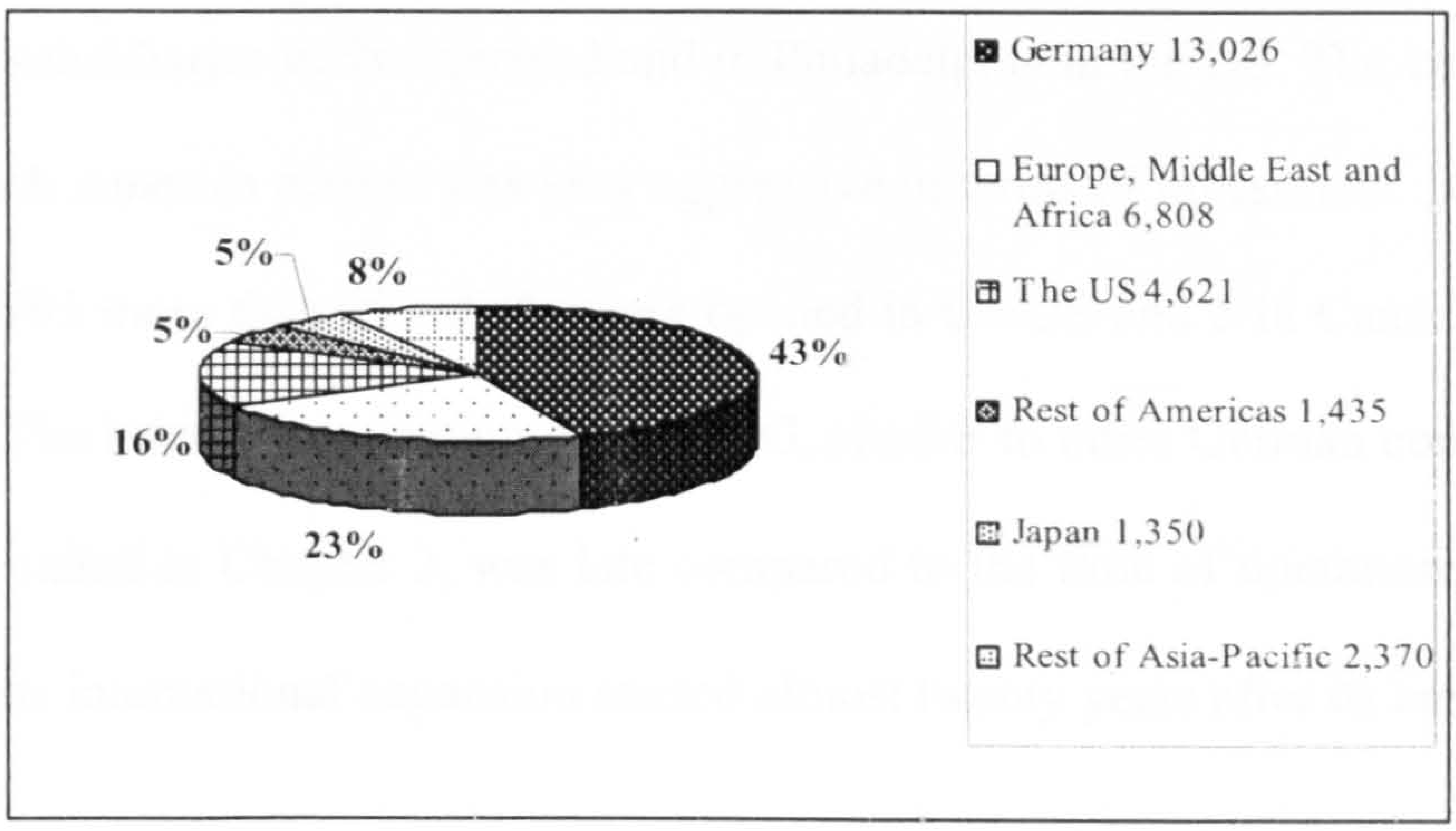
The aim of this chapter is to present and discuss the MNC subsidiaries from the business software industry. Doing this, it describes the presence of the control mechanisms in the SAP subsidiary for the Andean and the Caribbean region (hereafter SAC) and in Baan distributor (hereafter exBaanVe) in Venezuela.

The chapter is structured as follows. Firstly, it presents the evolution of SAP AG, stressing its internationalisation process and ownership structure. Then, it describes the setting up of the subsidiary in Venezuela, emphasizing its market positioning and the development of capabilities in the local unit. Thirdly, the different control mechanisms in the subsidiary are presented. The same structure is followed to present the Baan case. Finally, the main conclusions of the chapter are discussed. This chapter provides the basis for the comparison of the four case studies in the next chapter. The cases presented here are grouped by industry and the comparison of the control mechanisms are made according to the country of origin of the MNCs.

6.2. SAP AG

SAP AG is a German technology firm that develops e-business software solutions. Its corporate offices are in Walldorf, Germany and the MNC has operations in more than 100 countries. The German firm has more than 13,000 clients who run around 30,000 operations of SAP software. SAP AG is one of the four largest German companies in terms of market capitalisation and the fourth largest independent software group in the world (The Financial Times, 1998). In 2003, the company had 29,610 employees worldwide, with the largest concentration (44 per cent) in Germany (SAP AG, 2003). Figure 6.1 presents the distribution of the workforce by regions.

Figure 6.1 Distribution of SAP AG Workforce by Regions



Source: SAP AG (2003).

The firm was created in 1972 when a group of German engineers left the German subsidiary of IBM to start their own software company. Initially, the company developed business software packages for specific administrative functions, developing later an integrated business software package called enterprise systems.

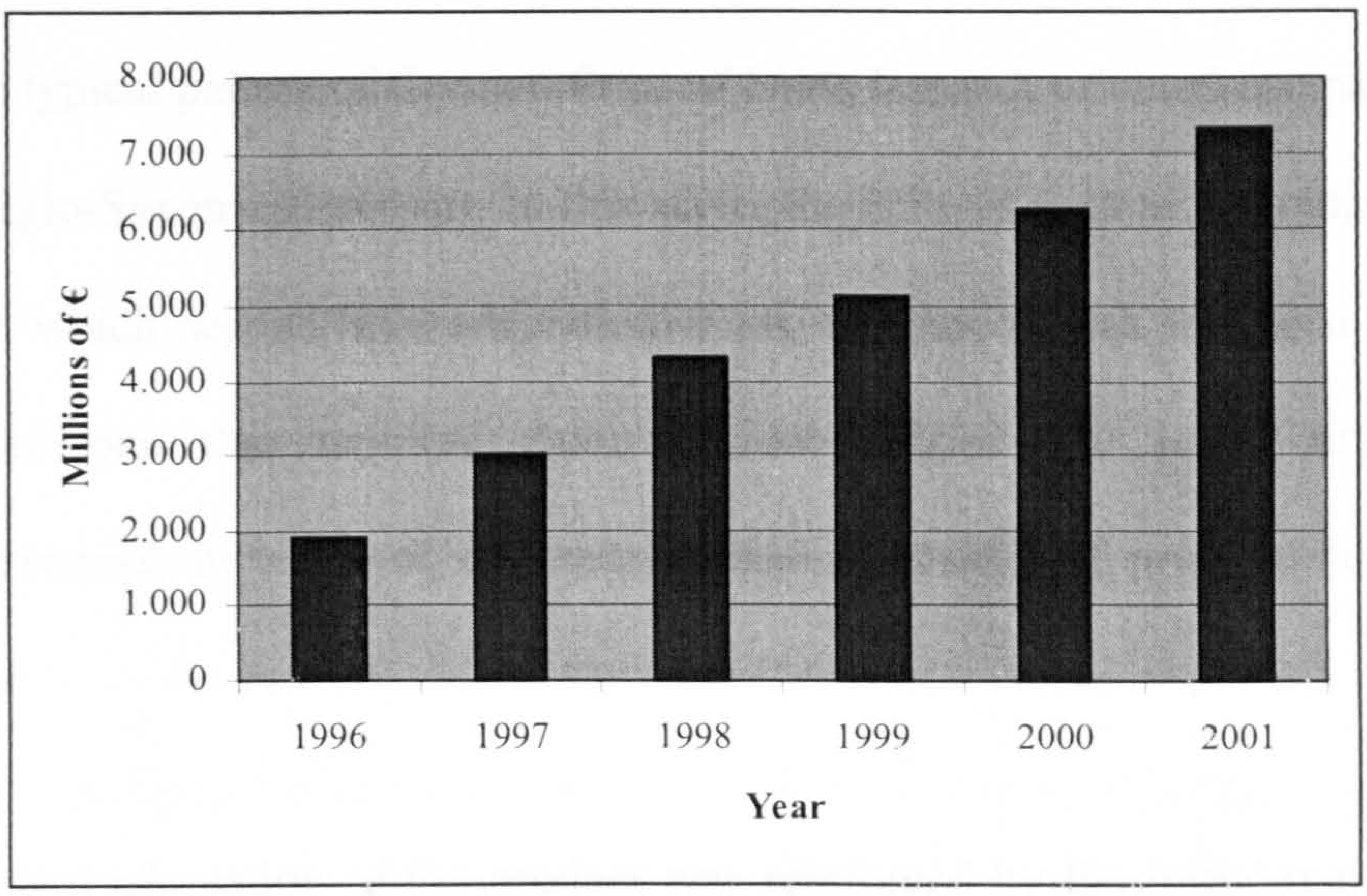
6.2.1. The Internationalisation Process of SAP AG

In the late '80s, SAP AG started its internationalisation, following the typical German export pattern. The first international market was Europe and the marketing of the software was through the German subsidiaries of European MNCs, which implemented the software and promoted it to corporate offices. During this early stage of internationalisation, European clients negotiated with SAP AG offices in Germany. However, in 1988 the German firm adopted an aggressive FDI strategy to expand operations internationally. It opened fully-owned subsidiaries in Switzerland and in Philadelphia in the US. The entry into the North America market was very aggressive in terms of investment. Between 1992-1995 more than 20 offices were opened in the US and 5 in Canada (Nee, 1995). The internationalisation of SAP AG, similar to other German companies as was stated in Chapter 3, was late compared to the time of operations of the MNC: its international expansion started almost twenty years after its creation.

During the next years and until 1998, SAP grew spectacularly in terms of sales and the opening of many subsidiaries supported this expansion. The characteristics of the industry, highlighted in Chapter 4, create pressures on SAP to become the standard software and create economies of scale on the demand-side. As the main competitors of SAP AG where in the US, the firm had to grow fast in this market. The accelerated international expansion was assisted by the creation of regional reporting centres, such as Austria as headquarters for the central sub-region of Czech Republic, Hungary, Poland, Slovakia, and Slovenia, and SAP America in Philadelphia as report centre for

Canada, the US and Latin America. The accelerated expansion of the MNC can be seen in the increase of the revenues during 1996-2001, which are presented in Figure 6.2.

Figure 6.2 SAP AG Revenues 1996-2001 (in € millions)



Source: www.SAP.com.

The strategy followed by SAP AG until 1998 is typical of German MNCs presented in Chapter 3, table 3.6. It shows little diversification of products, high concentration of the MNC operations in Germany and the concentration of investment in familiar business environments. The MNC did not diversify its Rand D activities to develop new software products in addition to the ES. The Rand D activities were focused on the development of a single, integrated product that could then be shipped in the same way to all customers. The company until 1998 centralised its Rand D activities mainly in the corporate offices of Walldorf, with some other research centres in Berlin, Karlsruhe and Saarbruecken in Germany.

The organisational structure of SAP AG until the late '90s fitted the global organisation model of Ghoshal and Bartlett (1998). The MNC concentrated its assets, Rand D activities and decision-making in Germany. The rationale to open a subsidiary was "follow the customers": they sold the software first to a large client and then they opened the subsidiary in the country (Nee, 1995). It shows a typical pattern of German firms of being less risk oriented compared to their Anglo-Saxon counterpart. In this stage, the ES was seen as a standardised product, which needed little adaptation. Thus, the market was seen as a single integrated one that required from the subsidiaries low levels of local responsiveness, in terms of the creation and adaptation of products to local markets.

The limited adaptation of the product was reinforced by the initial marketing strategy of the German MNC. In its initial growth, the main clients of SAP AG were MNCs, and the firm concentrated its sales efforts on this niche. However, as was stated in Chapter 4, the changes in the structure of the industry forced SAP AG to alter its initial strategy. In order to cope with the new demands of the clients SAP AG had to readjust its strategy and structure.

A process of decentralisation of Rand D activities was initiated in 1998. SAP labs were opened in France, Japan, India, the US and Canada. The following year, the company launched a series of Internet-related applications. These changes in the portfolio of products developed by the MNC increased the number and the type of competitors of the firm. They were not only the providers of ES: Internet application vendors and other business software providers became direct competitors of the MNC.

In addition, SAP AG abandoned the tradition of developing all software in-house, and created alliances with competitors such as Commerce One and Yahoo, one of the leading companies in internet portals, in order to support the diversification of the product portfolio and to speed up the development of new software (The Financial Times, 2000). The company also created other subsidiaries with autonomy to develop specific types of products, such as SAP marketplace and SAP portals in Palo Alto, California, in an area where the main competitors of the company had their Rand D centres. The subsidiaries of the MNC according to the type activities carry out started to have different roles as Birkinshaw and Morrison (1995) have stressed may occur in MNCs. Despite the decentralisation of certain activities, the MNC has still a strong attachments to its country of origin in terms of the concentration of company workforce (44 per cent) in Germany and, importantly, a number of Rand D activities is still carried out there, too (SAP AG, 2002).

The US sales boom of SAP AG in the early '90s contributed to the expansion of the operations of the firm in Latin America, which is a small market compared to other regions such as East Europe and Asia which had higher economic growth over this period. The delay of SAP AG in entering this market has two explanations. First, the number of Latin America MNCs is small, the main niche for SAP's products. Second, the small number of European subsidiaries in Latin America did not make attractive the setting up of subsidiaries to offer SAP's software: instead the service could be provided from the US offices or even from Germany. However, the entry into the US market al. tered this situation. Many US MNCs have subsidiaries in Latin America and SAP AG had to expand its operations to these countries: in many cases, the US operations abroad were large, and SAP AG had to open subsidiaries to service these users abroad. The global character of the sector described in Chapter 4 was the other driver of the process of expansion of SAP AG, together with the need to become the standard software of the industry. Competition among software firms is not local: they need to expand globally rather than to concentrate in few countries according to the characteristics of the industry explained in Chapter 4.

Although, SAP AG was under strong pressures to have a global presence in a short period of time, its strategy of growth has been planned following a cautious German expansion pattern. The opening of subsidiaries in Latin America responded to this need to have a presence in places in which there were large clients.

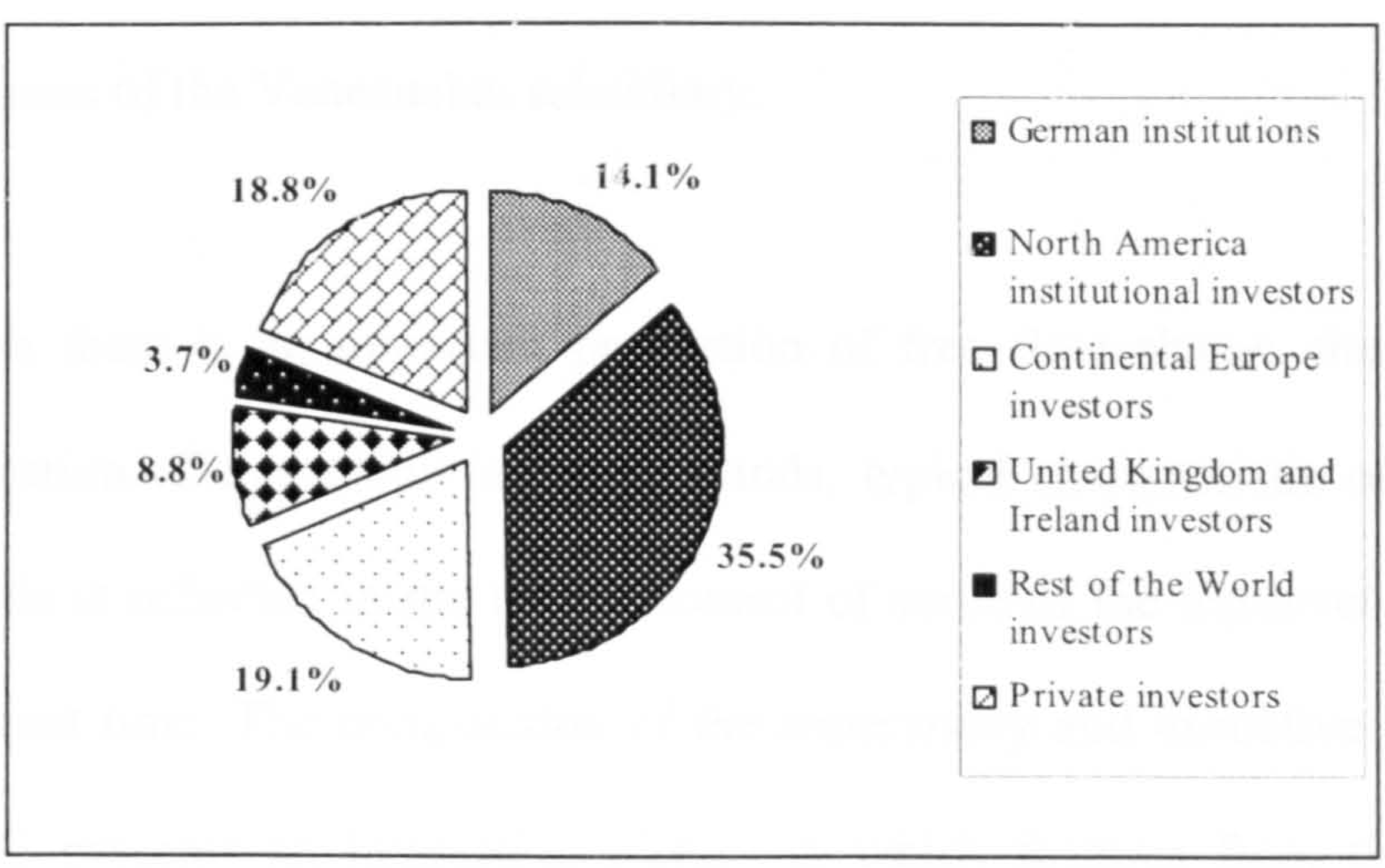
In 1994, SAP AG set up its first subsidiary in Mexico, where US MNCs have considerable investments. The following year, 1995, the German MNC opened subsidiaries in Brazil and Argentina. The strategy of SAP AG to sell the software package to MNCs made these countries the most attractive in the region in which to open subsidiaries, because US MNCs had operations there as well as there being large indigenous firms in this locations.

6.2.2 SAP AG Ownership Structure

In its ownership structure SAP AG presents an interesting combination. On the one hand, there is a significant amount of shares in the hands of the cofounders, a typical German pattern. On the other hand, a significant number of Anglo-Saxon institutional investors hold a number of the shares of SAP AG.

SAP AG ownership structure has an important participation from the cofounders of the company, with almost 35 per cent of the stocks. The rest is split among institutional and private investors coming from Germany, North America and the rest of Europe (see: www.sap.com). The ownership of the free float shares of the MNC is presented in Figure 6.3.

Figure 6.3 Shareholder Structure of SAP AG Free Float Shares (2003)



Source: www.sap.com.

A large proportion of the free float shares are held by American institutional investors (35.5 per cent), with 19.1 per cent that are in the hands of UK investors; the German investors only hold 14.1 per cent. Anglo-Saxon investors hold more than 40 per cent of the public shares of the company. In order to keep the investment of the latter group in the company, and to avoid the possibility of aggressive takeovers: SAP AG has to fulfil their demands for high shareholder returns in the short-term. This pressure cascades down to the profit centres such as the subsidiaries. The SAP CEO in the 2002 annual report clearly expressed this objective:

> *The greatest challenge was adjusting to slight or even no revenue growth – instead of the 15 per cent growth originally expected – while increasing profitability. SAP has improved overall efficiency in the long term, not with massive reductions in staff, but through careful cost-cutting measures and rationalization of our global infrastructure.*

The MNC has implemented strong financial controls to monitor the achievement of quarterly sales results and to policies to being more cost-efficient, they are discussed in great detail in the analysis of the control mechanisms of the Venezuelan subsidiary.

Although there is an important proportion of free float shares, there is still concentration of ownership in family hands, typical characteristic of German firm. This is reflected in the family control of some of the top-level positions until recent time. The composition of the supervisory and executive boards in SAP AG presents an interesting picture in which features from the typical German firms coexist with other practices which are not typical of this context. There are few independent representatives, such as the president of Nokia Corporation and the director of the institute for information systems at a German research centre of artificial intelligence. Two of the SAP cofounders are members of the supervisory board and one of them was CEO until 2001. The SAP AG executive board is dominated by those with long careers in the company (see: www.sap.com).

In 1988 the firm changed to SAP AG and carried out its first public offer on the Frankfurt stock market. By contrast to traditional German firms, SAP AG in its initial operations did not obtain funding from German banks. It went to stock markets to avoid banks' involvement in the supervisory board (The Financial Times, 1998). The concern of banks in protecting the value of their loans created pressures to adopt conservative business policies that could limit the speed of the international expansion of SAP AG. In 1998, ten years later, the company sold its stocks on the NASDAQ stock market. SAP AG adopted the US GAAP, instead of continuing to follow the GAAPs under the German Commercial Code.

The marketing strategy of SAP AG, originally, concentrated on the sale of business software. It considered itself as "software business seller". However, the mature stage of the industry that forced the MNC to search for new business opportunities and introduce new solutions that can be sold to current clients, transformed the relationship between the firm and its customers. This strategy is also seen in the role adopted by the subsidiaries of the MNC.

6.3 SAP for the Andean and the Caribbean Region

The subsidiary of SAP in the region is responsible for a set of operations in the Andean and Caribbean region. The subsidiary in Venezuela centralises the management of the offices in Colombia, Peru and Puerto Rico. The Venezuelan office is directly responsible for the operations in the Caribbean, and the entire operation of the subsidiary employs 160 people (SAP AG, 2003).

The market entry of SAP AG into Venezuela, following the German export model, aimed to give service to local clients from abroad. There were a number of firms from Colombia and Venezuela that implemented the business software system, however, the sale was negotiated from the US or Germany. The medium size of the first users and the characteristics of Venezuelan and Colombian firms, which was explained in Chapter 4, did not support the investment in a wholly-owned subsidiary.

However, in 1996, SAP AG set up formal operations in the country. *PDVSA*, the Venezuelan NOC, was interested in the implementation of ES to integrate its operations. The size of *PDVSA*, which in 1999 had around 33,000 employees in its local offices and 15,000 employees in its foreign offices, created enough incentives to SAP AG to open a subsidiary in the country.

In the first year of operations a team of expatriate managers and technical experts came to manage the subsidiary. SAP AG compared to the other case studies used the expatriates for short-term assignments to set up subsidiaries. The average for the expatriate assignment was one-two years, and the expatriates mentored the first locals hired by SAP AG in Venezuela. The process of acculturation was not only through the presence of expatriate managers: the locals also had to travel to the MNC offices in the US or Germany to learn methodologies on specific software. By contrast, to the oil subsidiaries in which the locals have had few opportunities to develop networks with the rest of the MNC, SAP AG has a process of acculturation described by a local manager like this:

> *When I was hired, the first thing that I had to do was taking a flight and spend three months in Boston. The training there was linked to the features of the technical products. When I came back, I had a person assigned to train me. His role was more to introduce me to SAP organisational issues and to teach me how I should do things.*

After the subsidiary was set up, the local team had to look for clients in Venezuela and in the rest of the region. Local sales targets were negotiated with the local managers in the Venezuelan market but also they had to search for business opportunities in neighbouring markets such as Colombia and Peru. The strategy of SAP AG for the region, as the Venezuelan market was small, was to expand operations to the other Andean countries. The initial sales to other regions were coordinated from Venezuela. In 1997, SAP AG set up offices in Colombia and Peru, and two years later they opened an office in Puerto Rico. The Venezuelan managers trained by the expatriates undertook the subsequent opening of Colombia, Peru and Puerto Rico offices and were responsible for organising them. A cadre of expatriates still came but only to support the local managers in technical specifications of products.

The initial relationship between the Andean offices and the US offices was very tight. The core activities of the subsidiary were sales and marketing and the subsidiary depended on corporate offices for new software and up-grading of ES versions. However, the subsidiary went through an evolutionary process, which changed its initial structure.

6.3.1. Market Positioning of the SAP Subsidiary for the Andean and the Caribbean region

The initial strategy of SAP in Venezuela and the rest of the region was to target the niche composed of large firms. The Venezuelan subsidiary, pursuing this strategy, became a leading software supplier in sectors such as engineering and construction, oil and gas, pharmaceuticals, and mass consumption products in which the larger firms of Venezuelan and the rest of the region have activities.

The strategy to expand operations regionally was driven by two factors. On one hand, the large firms in Venezuela, Peru and Colombia very often have operations in neighbour countries in the region. Therefore, SAP AG had to offer services to the offices of the user of the software in the region. On the other hand, the small size of the local markets created pressures to implement the software in many firms as possible in order to create a lock-in effect.

Despite the successful efforts of Venezuelan subsidiary to implement the software in the largest firms, the characteristics of the Venezuelan industry with its largest group of small and medium enterprises constrained the growth of the subsidiary. The niche of large firms became mature. In 1999, it became difficult for the Venezuelan subsidiary to achieve its annual sales plan. In an entrepreneurial subsidiary action (Birkinshaw, 1997) a regional initiative was approved to adapt a standard software package to the necessities of local small and medium firms. A whole local initiative was developed: a) there was a market research in Venezuela to detect the needs of local firms; and b) to reduce installation costs of the software, the subsidiary negotiated alliances with local companies rather than with international companies to cut down the overall cost of the software. This strategy helped the subsidiary to reach its sales forecast at the end of the year. The next year, the same initiative was launched in the Colombia and Peru markets. The approval of this initiative shows changes in the relationship of the subsidiary with corporate offices. A less hierarchical relationship in which the subsidiary can adapt product and services to the local context is developed in the evolution of the subsidiary.

6.3.2. Subsidiary Evolution and the Development of Capabilities

The subsidiary in Venezuela experienced an evolutionary process in its role. In its initial stage the subsidiary was highly dependent on corporate offices for resources, knowledge and personnel. However, after the subsidiary began to generate its own knowledge (e.g., technical expertise and knowledge of the local environment), it had more power to negotiate with corporate offices and could adapt software products.

In its evolution the Venezuelan subsidiary has developed a set of capabilities. In the technical area, the business software has been adapted to the characteristics of medium and small firms. This local initiative has been exported to other neighbour countries in Latin America. Another capability developed in the subsidiary is the knowledge of the local context. The sale of business software products demands a close interaction between customers and the ES supplier. The role of the subsidiary in the development of this relationship has been a valuable asset. This fact is enhanced by the strategic drive of SAP AG to develop a long-term relationship with its customers, which makes even more valuable the relationship that the managers of the subsidiary might develop with local clients. In the words of a subsidiary manager:

> *ERP is a mature market. We already have a base of clients and we can sell to those clients other technology components. You are not going to grow fast in number of clients, you are going to grow in number of products. That is my job. There is a middle market, a mini-market where you can sell low-priced solutions for simpler, straight or pre-configured products...mechanisms that you created to have a cheaper membership cost for the customers.*

Another valuable capability of the subsidiary, is the implementation of mechanisms to cope with the volatility of the local context. The political instability and economic volatility in the region limit the economic growth of firms, affecting their decisions to invest in technology. A local manager describes how the volatility of the region affects the operations of SAC in this way:

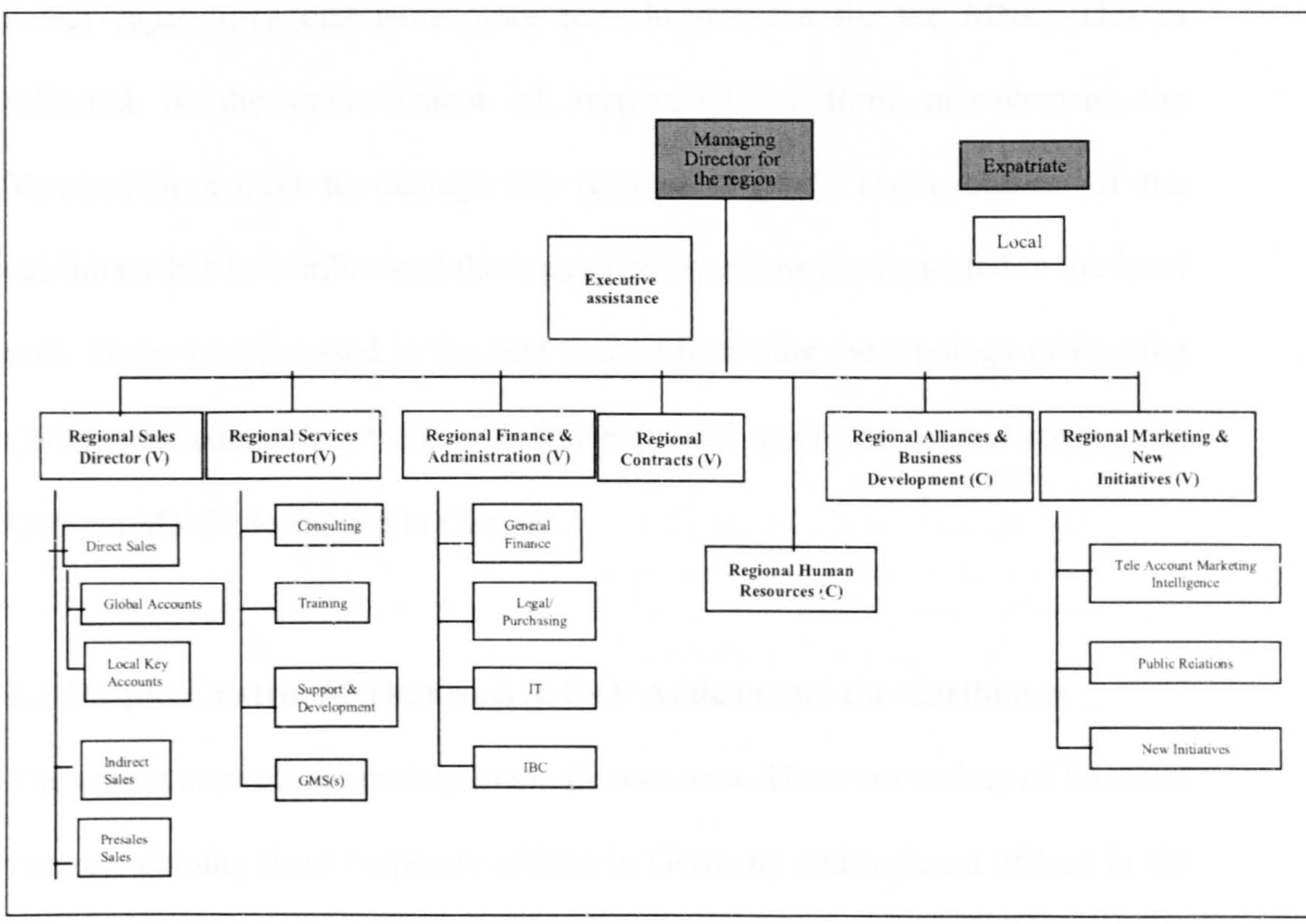
> *Our first challenge is to manage the political risk in general. For instance, in Colombia the political and social risks, which impact firms. They have to take decisions in an unstable economic and social environment, in which you really do not know what it is going to happen tomorrow. So your clients keep telling you: tomorrow. Let's see what happens tomorrow.*

This volatility of the context is reflected in two areas. On one hand, the subsidiary managers need to have particular negotiating skills to deal with clients, which might be different from the skills required to carry out sales in more stable contexts. On the other, the subsidiary has developed internal financial mechanisms to protect against the risk of local instability. For instance, three years ago, SAC developed a protective mechanism for immediate reaction in the case of increases in credits rates, devaluation or control exchanges. Some of these practices have been exported to other Latin America countries that share similar regulations or economic conditions. However, the transfer of these practices is constrained to the Latin America context, because only other subsidiaries in the region face similarities in terms of economic fluctuations and tax regulations.

A process of subsidiary-driven charter reinforcement (Birkinshaw and Hood, 1998) has occurred in the evolution of the subsidiary. The main activities of the subsidiary, sales and marketing, have been reinforced and the Venezuelan subsidiary is in charged of these operations of Colombia, Peru and Puerto Rico. The initial offices in these countries had a functional structure, with finance, sales, professional services and human resource departments and a country manager for each of them. Each country unit, although they were not subsidiaries, were operating as independent profit centres with their own local sales strategy.

In 2001, the Venezuelan subsidiary, SAP Venezuela, became SAP Andean and the Caribbean (SAC) with a shared service structure to manage the Venezuelan, Colombian, Peruvian and Puerto Rican offices. The new structure for the Andean subsidiary is presented in Figure 6.4. As this figure shows, the main activities of the subsidiaries were grouped on a regional basis, eliminating the functional structures in each country.

Figure 6.4 Organisational Chart for SAP Andean and the Caribbean region (2001)



Source: HR Department in SAC.

The managers in the subsidiary are distributed between Venezuela and Colombia. For instance, the regional sales director, regional services, finance, regional contracts and marketing and new initiatives directors are in Venezuela, human resource and regional alliances and business developments managers are in Colombia, with the majority of functions regrouped in Venezuela. In addition to cost efficiency, the shared service structure in the case of SAC also has the function of centralising operations. According to the managers of the subsidiary the new structure allow them to have a better picture of the operations.

SAP Venezuela has evolved into a subsidiary that has reinforced its original charter, becoming a subsidiary that manages a region. It has had the ability to create capabilities that have more than local value for the MNC. This is reflected in the enhancement of responsibilities from management the Venezuelan market to manage the regional market. The evolution of the subsidiary has had influenced the type of mechanisms implemented in the local unit. These are discussed in the next section following the typology of Harzing (1999) and comparing them with the expected model of control strategy in German MNCs developed in Chapter 3.

6.4 Output Control Mechanisms in SAP Andean and the Caribbean

The output controls are mainly in the finance area. There are variety of financial controls coming from corporate offices in Germany and regional offices in the US. Their major aim is to detect deviations from business plans in terms of sales and costs.

For instance, there is a set of activities to estimate the annual sales. SAP AG discusses the strategic guidelines of the MNC with the subsidiaries in a kick-off meeting. According to the strategy of SAP AG, the managers of the different

Americas' subsidiaries meet to review the portfolio of SAP products and they develop a regional business plan considering the business opportunities in the region. This business plan is subject to revision and approval from the Latin America regional offices in the US; after its approval comes the elaboration of the budget, which is carried out by each subsidiary.

The planning activities for the year are carried out at two levels. A corporate one, which defines the strategy of the MNC and at subsidiary level which according to its resources defines its contributions to the strategy. The planning process is a mix of integration and localisation. A project manager of SAC from the industrial sector describes the planning process in this way:

> *SAP AG in Germany develops the corporate guidelines, policies, business orientation, and business development; the guidelines to know where we are going. SAP America in Philadelphia translates these guidelines to the American context: they say we want business with this profitability, we want to grow in these sectors and we want to develop this product. Then we need to put these demands in operative terms, like to generate a business practice in CRM or supply chain management. You start to look in the region for potential clients, what are our resources (people), and we start to distribute activities in the group.*

The business plan is forecast every month in the departments that generate revenues, such as sales, consultancy, service and support, and training activities. They also have to report revenues quarterly to the Latin American offices in Philadelphia. A set of cost reports to control working-hours per person in consultancy and support, and services activities are elaborated, too. For instance, there are monthly reports of consultancy-hours.

The strong driven in the subsidiary on profits and cost control is in almost every financial control in the subsidiary. Following a corporate requirement, SAC has implemented a program of cost reduction in its operations. Every year, the preparation of the budget includes a portion of costs that has to be reduced.

Other mechanisms of control are frequent conference calls with the managing, sales and financial directors in the subsidiary and the managing director and financial director for Latin America to check current revenues and progress with potential clients. There are also mechanisms to benchmark the performance of the subsidiaries in term of profits: they are elaborated in Germany and are controlled by the finance manager in the subsidiary.

In terms of financial controls, they are strongly present in SAC. A strong driven to follow up short-term revenues is the main driven in the financial controls implemented in the subsidiary. The generation of profits in the short-term is closely monitored in the subsidiary, contrary to what would have been expected in a German MNC according to the control strategy of German MNCs. The ownership structure of the firm with an important proportion of Anglo-Saxon institutional shareholders has its influence in the nature of this control in the subsidiaries. Compared with Preussag Energie, SAP has implemented a set of financial controls that are oriented to prevent deviations from the financial planning rather than legitimate financial operations in the subsidiary.

6.5 Bureaucratic Formalised Control Mechanisms in SAP Andean and the Caribbean

SAC is highly standardised in the technical area, a control mechanism that is distinctive of German firms. The global character of the ES industry is another reason why the company places strong emphasis on the standardisation of procedures in SAC. SAP AG products are business pre-packaged solutions for functional areas in organisations; therefore, from their conception these solutions are highly standardised. Finally, the size of SAP AG, with more than 29,000 employees spread worldwide, brings strong demands to unify operations and make more predictable the outcomes of the units of the German MNC.

For instance, SAC has many manuals in the technical area, many of them on-line, regarding sales proposal elaboration, lists of sales prices, steps to implement the business solutions, information on support and service activities, and types of agreements with consulting partners.

Standardisation does not come only from outside the subsidiary: there is a tendency to standardise procedures internally following the German tradition. There are local coordinators to formalise and unify procedures in the different areas of the subsidiary. The standardisation can be completely local or might take templates developed in other parts of the MNC and adapt them to the local context. For example, the Regional Alliances and Business Development and Human Resources Departments have written policies and procedures locally developed. In the case of HR policies, such as the compensation policies, they are designed in the US regional centre.

Another area highly standardised is the finance department in the subsidiary. The Finance Director of the SAC subsidiary explained the levels of standardisation in this area as follows:

> *We allow creativity from the members of the team. Their propositions have to come to my level to be evaluated and adjusted. We do not permit that each country manages its operations in a different way. Everything has to be uniform and the only changes between countries are adjustments for tax or legal reasons. For example, Colombia has control exchange, but apart from this, everything is standard and is written in policies, norms, procedures and formats on public files shared by all members of the subsidiary.*

The levels of standardisation of SAC can be explained by three reasons. First, the tendency of German firms to standardise procedures and norms. Second, the pressures to have strict controls on financial results in the short-term which influence the development of financial standard devices. Third, the need to offer a standard product creates the need of integration through standardisation.

6.6 HR Practices and Policies in SAP Andean and the Caribbean

The HR function in SAC has a more strategic approach than the traditional HR function in German firms. The subsidiary has also implemented a few Anglo-Saxon practices. However, this implementation of more strategic and global HR practices is mediated by the characteristics of the country of operations. For instance in terms of compensation, there are a set of global policies developed abroad which are different from the traditional German remuneration system.

SAP AG has implemented Anglo-Saxon practices such as stock options plans. The MNC has developed different optional plans to offer to the employees the possibility to buy stocks; however, the subsidiary has the choice to decide how to implement the option plan, on what terms and to which managerial levels. The characteristics of the local context, highly volatile, do not support incentives based on long-term investments as part of the salary of the employees. Therefore, the local human resource department can negotiate the terms of the implementation of this type of practice.

Other compensation practices such as a variable compensation linked to the achievement of specific goals by managers have also been subject to local adaptation. The local knowledge of the HR department of the preferences of local managers concerning rewards, contributes to designing attractive incentives for them. In addition, corporate mandates about salary increases are subject to modification. There is a per centage of increase dictated by SAP America offices; however, this increase is subject to negotiation with SAC. The local economic conditions and their effect on the subsidiary operations are in some cases reasons to decrease the per centage of the salary increase dictated by corporate offices. Local labour regulations shape the nature of the benefits and perks in the subsidiary, which also have an impact on the total compensation of the employee.

The performance evaluation program is global but subject to adaptation, too. It is transferred from German corporate offices. SAC has the option to choose between the US and the German models, which are implemented according to the region. In the case of SAC, the managerial group decided that the US model did not fit the subsidiary culture; therefore, the subsidiary went for the German model that was more appropriate according to the local view.

Job descriptions are another practice subject to localisation. The general job description for each position comes from America regional offices but they are adapted locally. These descriptions, usually, are for larger subsidiaries in which the job activities for each position are fewer. The centralisation of activities with the shared service structure in SAC has added more responsibilities to the positions in the subsidiary. So, the local job descriptions are adapted to the local specifications of the job.

The nature of certain HR practices such as compensation, performance evaluation and job descriptions is more strategic and global. They do not follow a German pattern in their nature and their implementation in the subsidiary is adapted to local circumstances. Technical training is other practice that follows global standards. Corporate offices design the major technical training and its execution is coordinated between the subsidiaries and the corporate offices.

SAP AG has developed a number of in-house technical programs for its employees. According to the area of operations, the employee has a set of technical courses that are part of his annual training. The training is carried out in-house, usually, and SAP AG relies on technology tools such as conference calls, multimedia facilities and the Internet to disseminate new knowledge. The MNCs have created strong technical training programs in different sites: for instance, SAP AG has multiple agreements to fund positions in different universities in Germany and also supports learning projects carried out through the internet. Moreover, the company has a University Alliance Program which provides software training at no cost to students at hundreds of higher education institutes in different parts of the world (SAP AG, 2002).

SAP AG demonstrates high levels of standardisation and integration of activities in organisational areas in which there are stronger demands to "act and look" more alike. It needs to homogenise what is sold and to give the same service to clients dispersed worldwide, which is a consequence of the global nature of the software business sector. This global nature also affects internal operations: the high levels of interaction of employees from different subsidiaries bring pressures to have internal consistency, too.

The career development in the subsidiary is based on internal promotion. Local people who started in low organisational levels currently occupy top positions in SAC: there is a system of internal promotion in the subsidiary. This system of internal promotion is connected to a long-term employment commitment. In the words of a local manager:

> *I think that the fact that it is a company with corporate offices in Germany makes interesting their methodologies, to see how the Germans manage the business, you can even see that many people*

stay for a long time in the company. The employee turnover, I think is very low or at least I have perceived that.

SAP AG has developed a program of an international career, which in theory implies the existence of opportunities for locals to move abroad on international assignments. However, the opportunities for local staff are limited. The characteristics of the local environment are again the main reason that constrains this type of opportunity. As the subsidiary HR manager expressed it:

> *There is a policy that states that the outstanding people have the chance to move within the group. The transfer policies are very clear. They are sent from Germany and validated in the States. The only bad thing is that in my region, I do not have the possibility to send as many as I would like to these transfers. The reason is because in our countries it is difficult to get one transfer and the majority of people want to go abroad. Then, if everyone wants to go abroad, what people are going to work here?*

In the opposite direction, there are no assignments to the subsidiary from other units, regional centres or corporate offices. The political instability and lack of personal security are the main reasons argued for this. It can also be hypothesised that the lack of strategic value of the subsidiary operations compared to other SAP units does not make it attractive to support transfers to the subsidiary. The HR practices in the subsidiary are mix of imported practices which are localised and adapted to the local circumstances. The analysis of the HR practices in the subsidiary shows a strong effect from the host country in their implementation.

6.7 Expatriate Managers as a Personal Centralised Control Mechanism in SAP Andean and the Caribbean

The presence of expatriate managers in SAC is very limited. In the initial operation a cadre of expatriate managers stayed for a period of between one and two years. After the process of acculturation was completed, regional offices accelerated the substitution of expatriates by local employees. The only permanent expatriate position is the managing director who is a Spanish expatriate, who lives in the US and travels every two weeks to the subsidiary. The substitution of locals by expatriates has been relatively easy. SAP has found in Venezuela local people with the adequate training and experience to fulfil positions in the subsidiary: another factor which has helped to localise the workforce.

There is another group of expatriates who visit the subsidiary for technical reasons. The sale of the business software implies specific knowledge in some areas connected to either the business solutions or the industrial sector. In some cases, expatriates visit the subsidiary when there is not local expertise regarding this matter. A second group of expatriates from the financial area makes short visits to the subsidiary. They come either from American or German offices to check financial activities such as revenues and cost reduction plans. The expatriate presence on the short visits is to monitor activities, but they do not become involved in the execution of them.

The main reason for the absence of expatriates running the operations of the subsidiary is the type of activities that are carried out in it. The core activities in SAC are sales and marketing. Therefore, a clear understanding of local markets and business practices is fundamental to having a good performance. Local managers with their long training in the Venezuelan context might be more effective in dealing with clients. SAC has learned this fact from experience. German expatriates carried out the negotiations of the subsidiary with the first local clients, and it was difficult for them to manage this business relationship. The sale of the software was affected in many cases because the two parties had different negotiation styles, reinforcing the idea of hiring local workforce.

Another factor, which supports local presence, is the nature of local work practices. The implementation of business solutions usually creates changes in the structure and work practices in the firm. Locals are more capable, because of their cultural proximity, of managing and communicating the process of the implementations of the software. Their organisational experience is embedded in the local context. They have developed an implicit understanding, which helps them to identify and react according to the circumstances. A subsidiary local manager in this way justifies the presence of locals in SAC:

> *...the acquisition of one of these solutions brings changes. Sometimes radical changes in organizations; part of them, it is the cultural side of the people that you are working with. When the SAP and the user teams start to work together, a critical factor for success is the cultural proximity between the two teams. I think this is a key point to have a subsidiary in the country.*

The limited presence of expatriates goes together with permanent consultation with the regional offices in the US or corporate offices in Germany. The local managers cannot take decisions related to discounts on sales or to the approval of delays on client payments without previous authorisation. In addition any decision, which does not follow SAP AG corporate policies, requires the authorisation of regional offices. High levels of consultation and approval are substitutes for direct control through expatriates. The regional marketing and new initiatives manager describes the subsidiary-corporate offices relationship as follows:

> *Every important decision always has to be consulted: we have periodic meetings. In my case even though I report over to the managing director, I also have to report to the person who coordinates the marketing activities and new initiatives in SAP America in Philadelphia.*

SAP AG has almost no expatriate managers in charge of the operations of the subsidiary. Nevertheless, this absence of expatriate presence in managerial positions is substituted by tight controls in terms of consultation of decisions and approvals to implement local initiatives. As substitutes for direct controls the MNC has developed a set of mechanisms that in direct and indirect ways controls very closely the operations of the subsidiaries and the decisions taken by the local managers.

6.8 Controls through Socialisation and Network Development in SAP Andean and the Caribbean

Control through socialisation and network development is a mechanism that takes different forms in SAC. The acculturation of locals through the expatriates who came to organise the subsidiary acted as a socialisation mechanism in the initial operations. The frequent communication to consult and ask for authorisations moulds how locals take decisions and aligns them with the company way of doing things.

The MNC has developed a set of activities to reinforce the corporate culture, like communicating the mission, vision and values of the company. The implementation of a more Anglo-Saxon approach to managing the organisational culture is another tool that can be classified in the category of socialisation.

The flows of information in SAP AG are numerous in supporting the development of formal department relations. The knowledge-intensive nature of the activities of the MNC reinforces the implementation of subtle control mechanisms through the exchange of information between the members of SAC, people from other subsidiaries, and regional and corporate offices. For example, the configuration of virtual teams is an activity that supports exchange of information on one hand, and on the other is a mechanism to disseminate practices in the SAP AG. SAP subsidiaries create special teams called "virtual account teams" when they need to elaborate a sales proposal or implement a business software solution and they do not have enough local expertise to elaborate it. The members of the "virtual team" do not need to travel to the subsidiary: they communicate using electronic devices such as conference calls, videoconferences and e-mails. SAP AG, to strengthen this activity across subsidiaries, has developed an "internal knowledge community" which the subsidiaries can access and look for experts.

The different activities mentioned above also support the development of informal exchange of information. In addition, events such as the kick-off meeting are mechanisms to meet people from other subsidiaries, share experiences and develop informal networks. Technical training, which is standardised for all subsidiaries, is another way to develop this type of network.

The local managers visit frequently the offices of the US and Germany supporting the development of informal networks within the MNC. These trips have two functions. On one hand, the managers have to report activities to regional or corporate offices. On the other, there are periodic meetings to network with colleagues in the same industrial unit and exchange information about the needs of clients on new software developments. The areas of finance and HR also have meetings and conference calls to exchange information; however, they are limited to the Latin America region.

The subtle control mechanisms in SAC are numerous; they give cohesion to the group and facilitate the integration of activities, particularly in the technical area. The presence of expatriates is substituted by a set of devices that aim to develop the acculturation of the workforce in a subtle way. The review of the control mechanisms in SAC, which are presented in table 6.1, has highlighted some interesting points that are important to discuss.

Table 6.1 Summary of Control Mechanisms in SAC

Type of Control Mechanisms	*Control Mechanisms in German MNCs*	*SAC*
Output Control	**Low**	**High**
Bureaucratic Formalised Control	**High**	**High**
HR Practices and Policies	**Administrative and operative**	**Strategic and Global**
Personalised Centralised Control	**High**	**Low**
Control by Socialisation and Networks		
1. Socialisation	**Medium**	**High**
2. Informal exchange of information	**Medium**	**High**
3. Formal lateral relations	**High**	**High**

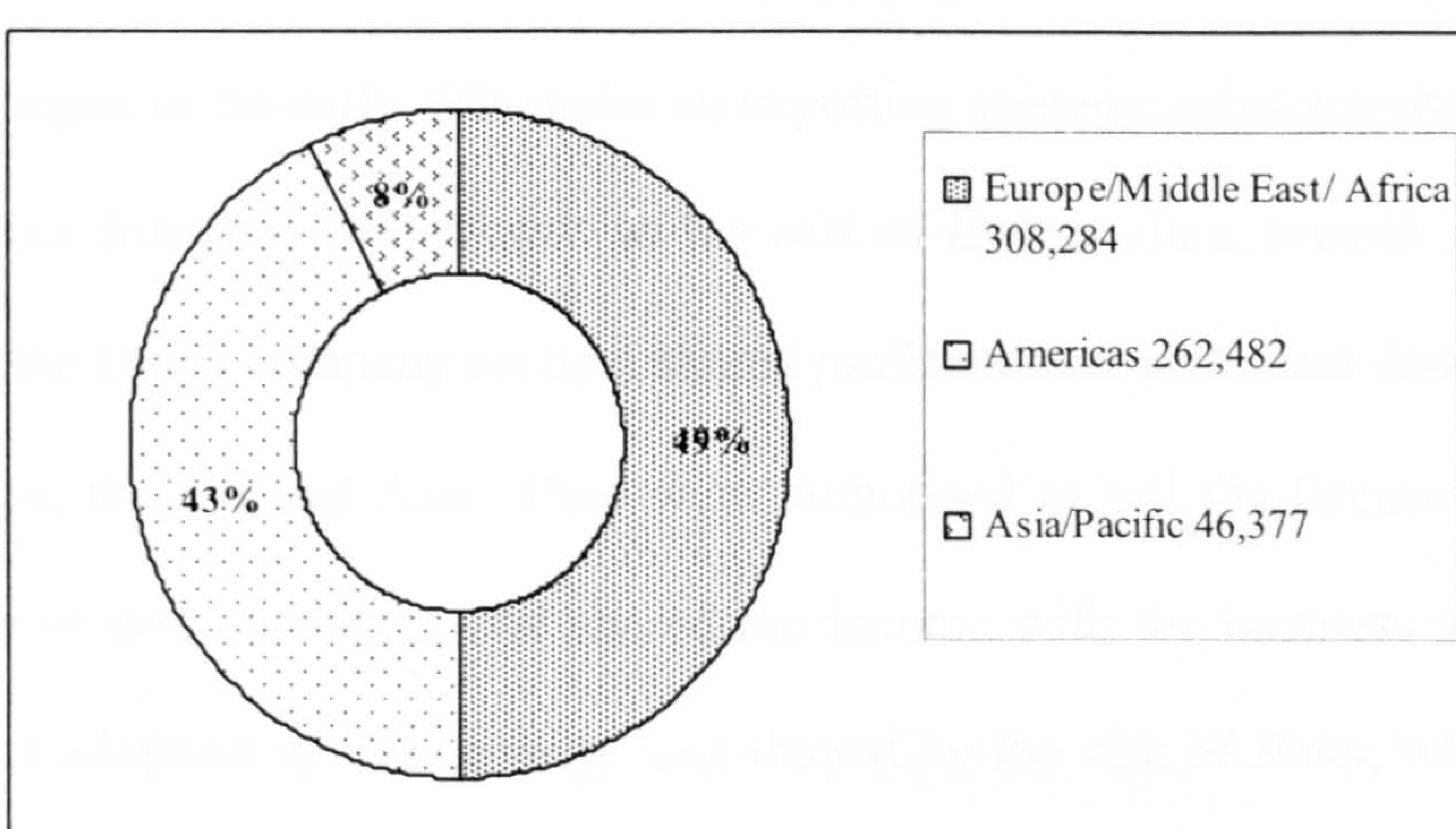
First, the strategic control on German MNCs according to the country of origin has some divergences from the original model developed in Chapter 3. There are other variables that influence the presence of control mechanisms besides home institutions such as the country of operations. The limited presence of expatriate managers, which is not characteristic of German firms, is explained by the characteristics of the country of operations. The large difference between the two countries and their institutional environments reinforces the value of local managers to supervise the operations of the subsidiary. However, the presence of local managers does not imply fully autonomy to the subsidiary. The frequent consultation of the major decisions in the subsidiary with regional and corporate offices is another way of direct control. In addition, the financial controls are a complementary form of control to frame the decisions taken by local managers. The implementation of the financial controls in SAP AG, which have a more Anglo-Saxon orientation, is evidence that the firm is becoming more detached from the country of origin on the one hand. On the other, it also shows that there are changes in the home institutions that are supporting another type of practices in German firms. They are going to be discussed with more detail in the next chapter in the comparison of the four cases.

6. 9 Baan Company

Baan Venezuela is the second case from the business software industry. The path followed by the Baan subsidiary in Venezuela (hereafter BV), since the MNC set up operations in the country, is remarkably different from the route taken by the SAP subsidiary.

Baan was founded in The Netherlands in 1978 and today is a leading global provider of ES. The MNC offers a portfolio of enterprise software applications that are in use by more than 7,000 customers.

Figure 6.5 Baan Net Revenues by Geographic Regions (in $ thousands)



Source: SEC (2000).

Baan has concentrated on the development of software in industries such as industrial equipment and machinery, automotive, aerospace and defence, and the high tech industry (Baan, 1999). In 1999, the company had 4,835 employees among corporate offices and its subsidiaries (SEC, 2000). Its revenues by regions in 1999 are presented in Figure 6.5.

Baan initiated operations as a small family business, which provided financial and administrative consulting services. Jan Baan, a founder of the company, detected a business opportunity in the use of software to automate the planning process for manufacturers: then, the firm started the development of business software in 1982.

6.9.1 The Internationalisation Process of Baan

The internationalisation process of Baan started relatively early compared to its German counterpart: eight years after the first software developments. The internationalisation of the firm was signalled by slow growth in the initial stages, which accelerated into a run to cover foreign markets in a short period of time. It began in the early '90s under an exporting strategy: sales activities were carried out from the Netherlands to the rest of Europe. In a second stage of growth, the Dutch company set up a shared profit scheme with local distributors in Europe, the US and Asia. They were authorised to sell the licenses of the software in these countries and shared the income with the business software firm. The adoption of this strategy was shaped by the size of Baan, which did not have enough capital to support a strategy of FDI and could not find in the local markets enough funding to finance an internationalisation process on a considerable scale.

This situation changed in 1993 when a US venture capital firm invested in Baan and boosted its growth in international markets. The US investor, following an Anglo-Saxon style, was interested in making profits in the short-term. A strategy to follow was to go public and sell the shares of the company on stock markets. However, it was important to be large in size and sales to attract institutional investors, so, the firm had to show a considerable presence in international markets. A third stage of growth started through an accelerated internationalisation, which has important implications in many areas of the firm.

Part of this growth was to set up an international service centre in the Netherlands and to acquire the accounts of large distributors in Germany and the UK. Because of the global nature of the industry, together with the large size of the US market, Baan developed an aggressive entry plan through DFI in the US. Its strategy of growth was to have direct presence in the largest markets and leave distributors in small markets. The firm continued its expansion through acquisitions of previous distributors in the US, Japan and South Africa, and setting up subsidiaries.

In order to support its fast growth, Baan changed its organisational structure. The expansion went together with a decentralisation of operations in sales and marketing. In 1994, Baan had two corporate offices, one in Barneveld, The Netherlands and the other in Virginia, the US. The US corporate offices were autonomous in taking decisions about marketing and sales strategies for the region. At this stage, Baan was adopting an international model of operations. The decentralisation of operations had the objective of localising products and services to the needs of the US markets. A Venezuelan manager explains the rationale behind this strategy:

> *They were autonomous and the business was split into two regions. They had their own power. The drivers of the America business were different to the drivers in Europe. The cultural aspect was important; therefore, it was central to have a Baan in the States. The Dutch culture would not have worked there.*

In the new structure the Rand D activities were decentralised, too. Rand D centres were opened in India, Denmark, UK and the US (SEC, 2000). The MNC as a part of its strategy had the intention to grow by number of products as well. The development of software in-house is a slow process and the firm faced strong demands to grow fast. It adopted a more Anglo-Saxon style of growth through acquisitions. Between 1994 and 1998, the MNC acquired a number of small and medium software companies to expand its product portfolio. These acquisitions diversified Baan products into software that was not connected to ES.

Since the beginning of its internationalisation, Baan has been concentrated in the niche of small and medium enterprises. By contrast, SAP had been oriented to the niche of larger firms such as MNCs. In 1999, the changes in the industry also forced Baan to embrace the Internet and created a product suite that supported e-business processes, which facilitated the interconnection between users and their customers and suppliers.

Baan's entry in the US market implied offering services to the US firms with operations in Latin America. By contrast to the strategy followed by SAP AG, which was more cautious in opening subsidiaries, Baan opened wholly-owned subsidiaries in many Latin countries. In 1994, the firm set up operations in the largest markets of the region, such as Mexico and Brazil. During the period of 1994-1997, five additional subsidiaries were set up in Argentina, Venezuela, Colombia, Chile and Peru (Baan, 1998).

The character of the global industry is reflected in the geographical expansion of the MNC. In the words of the Operations Vice-President for Latin America indirect sales:

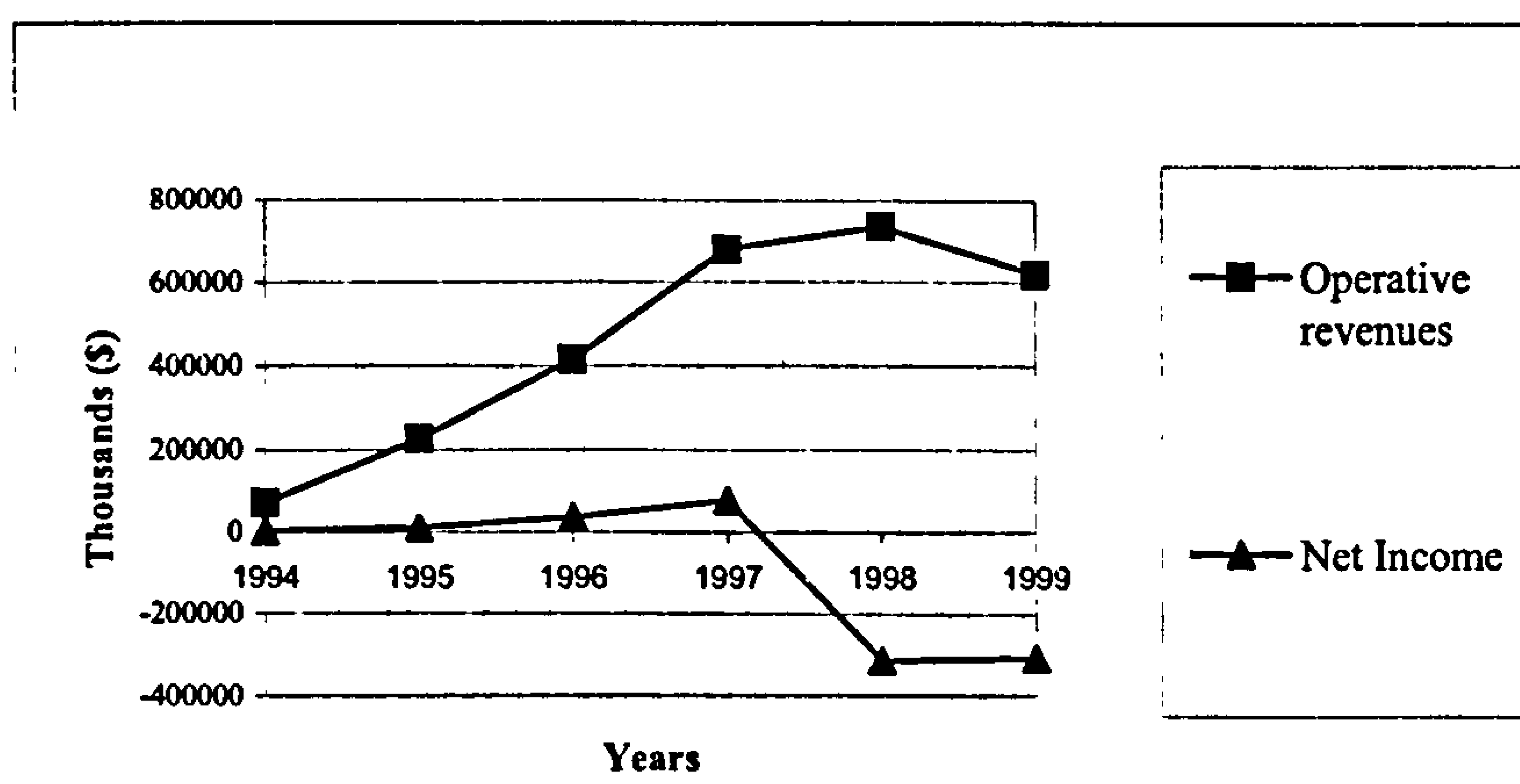
> *I think there are two elements. First, it is important to have many customers. Second, there is a global market; you have a number of MNCs that have operations in different countries. We have one in particular that operates in 7-8 countries companies in Latin America. You go and to talk to them about the business software and they say: my main operation is in Venezuela. Do you have offices in Mexico, Guatemala, Colombia and Ecuador? I have operations there too.*

The US offices controlled Latin America subsidiaries; it was a full decentralisation to the US offices, which dictated the corporate guidelines for the Latin America units. The communication with the headquarters in the

Netherlands and Latin American subsidiaries was minimal and only in the technical area with the Rand D centre.

Despite Baan's fast growth in markets and products, its profitability was erratic. The company could not generate attractive profits prior to 1996, as is presented in Figure 6.6. The aggressive expansion of the company was not supported by an integration of products, functions and administrative centres, and the costs skyrocketed in the company, affecting the share price.

Figure 6.6 Baan Operative Revenues/ Net Income 1994-1999



Source: Thomson Financial (2001).

A local manager describes the lack of integration on the marketing strategy of Baan:

> *The other problem was the Baan acquisitions. Baan had three* (software) *solutions for the same problem. In addition to Baan's original product, there were three additional ones with other brands, owned by Baan that did the same process. So, which one did we sell?*

In 1998, the firm went through a process of considerable restructuring that resulted in a reduction of approximately 20 per cent of the workforce as an attempt to reduce costs and increase profitability. An additional reorganisation was carried out at the end of the same year. The MNC announced a further reorganisation that resulted in approximately 14 more offices being closed and an additional reduction of headcount by approximately 4 per cent. In the countries in which Baan closed offices, they had to leave a representation to continue with support and services activities to current customers, then the partnerships with distributors were reassumed in these sites. In 1999, the company had 200 indirect channels covering 15 countries in the different continents (SEC, 2000).

The Latin America subsidiaries were also affected by the reorganisation of Baan. The fast expansion in the area was halted in 1998. The reduction of costs did not support the existence of subsidiaries for small markets because of the considerable operating costs. The subsidiaries in Colombia, Peru, Chile and Mexico were sold, the Dutch MNC left the subsidiaries in countries like Argentina, Brazil and Venezuela. The next year, the company decided to close the Venezuelan subsidiary and to give support to current clients through a distributor. The absence of large clients, who could generate substantial profits, was an important element in this decision. By contrast with SAP subsidiary in Venezuela which has an important and profitable customer as *PDVSA*.

The ownership structure of Baan played an important role in the strategy followed by the MNC. The next section presents how the interests of the shareholders moulded many of the decisions of the MNC.

6.9.2 The Ownership Structure of Baan

Baan's ownership structure has changed significantly since the foundation of the company, especially in the last decade. Baan until 1993 funded its expansion through cash generated from operations, long-term debt, bank lines of credit and loans from the principal shareholders (Baan, 1995). This type of funding did not support an expansion through FDI. However, the interest of a private equity investment, which acquired 34 per cent of Baan's shares, changed the strategy of the firm. The new investor provided the money to accelerate the expansion of Baan and in the short-term obtain high returns when the MNC would sell its shares on stock markets.

Two years later in 1995, Baan went public and listed its shares on the Amsterdam and NASDAQ stock markets. The financial statements of Baan were prepared according to generally accepted accounting principles in the Netherlands (Dutch GAAP) and according to the US GAAP, and the firm started to report on a quarterly basis.

Although the MNC went public in 1995, the two cofounders of Baan kept the control in the company, one as chairman and the other as a member of the supervisory board until 1999. Baan did not follow the pattern of considerable separation of control and ownership. In 1998 as a consequence of the low profits of Baan, public investors demanded changes on the management board, so the two cofounders resigned.

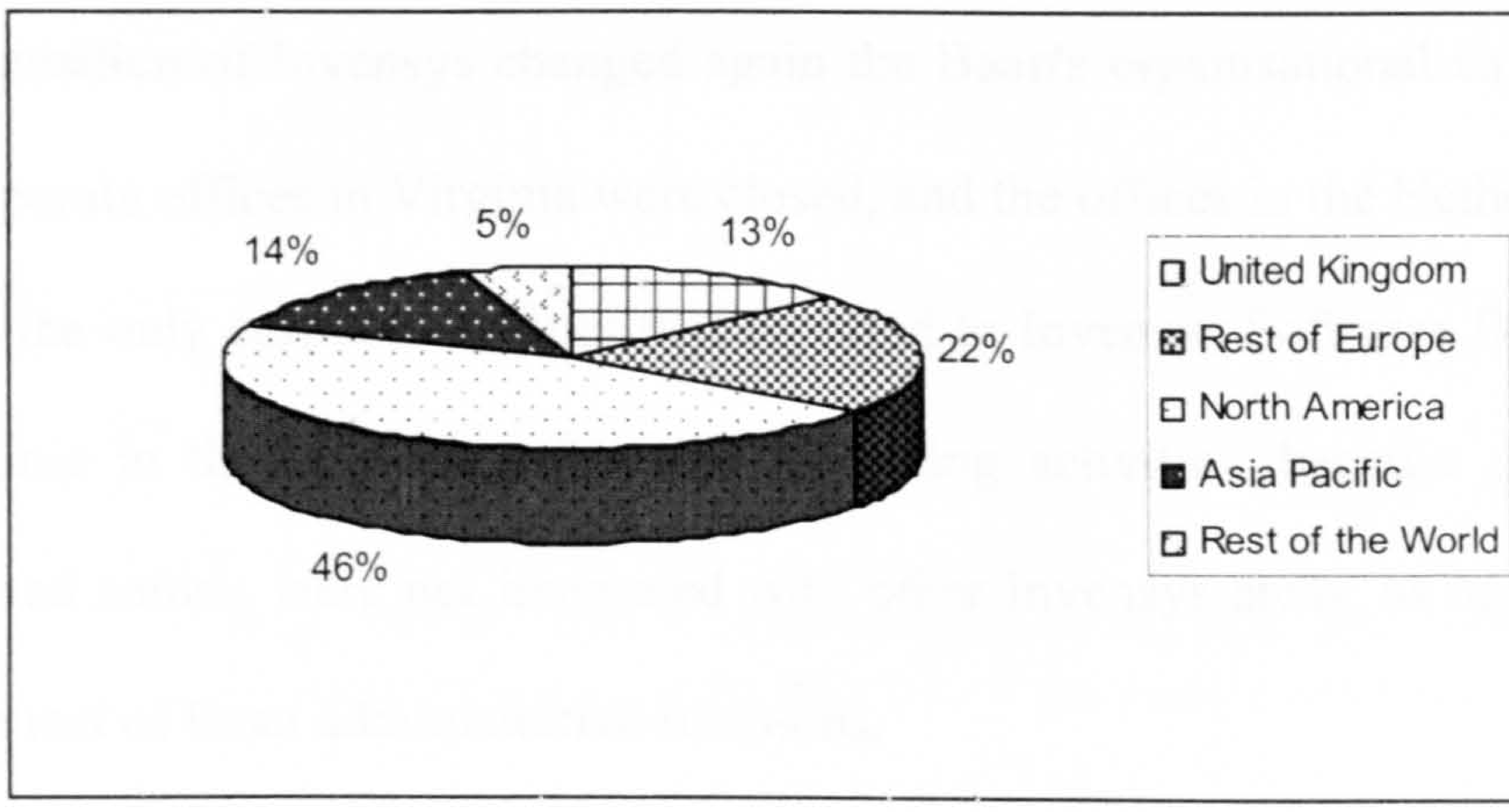
Baan's attempts to reorganise and become profitable failed: it could not meet the expectations of shareholders. The prices of the shares of the company fell sharply, and in 2000 Invensys, a British engineering conglomerate, acquired 82 per cent of the shares of Baan.

6.9.2.1 Invensys Acquisition of Baan

Invensys is the result of a merger of two British engineering companies BTR and Siebe. The merger of the two MNCs follows a typical Anglo-Saxon pattern of growth through mergers and acquisitions (Whittington and Mayer, 2000). The new conglomerate was the merger of a company that grew through acquisitions in the engineering sector, Siebe, particularly in the market of supplying automation and control systems, and another firm, BTR, which was an engineering conglomerate with a number of diversified operations in the sector. In 2001, Invensys had 93,519 employees. The geographical distribution of the workforce has a considerable internationalisation, with a significant concentration in the US. Figure 6.7 presents the workforce distribution according to regions.

The merger of the two British companies was followed by a reorganisation process and cost reduction program that created a more centralised structure, and the disposal of divisions that did not fit with the new strategy on automation requirements of clients. A business unit for software systems was set up to cluster all the business software packages sold by the group (Invensys, 2002).

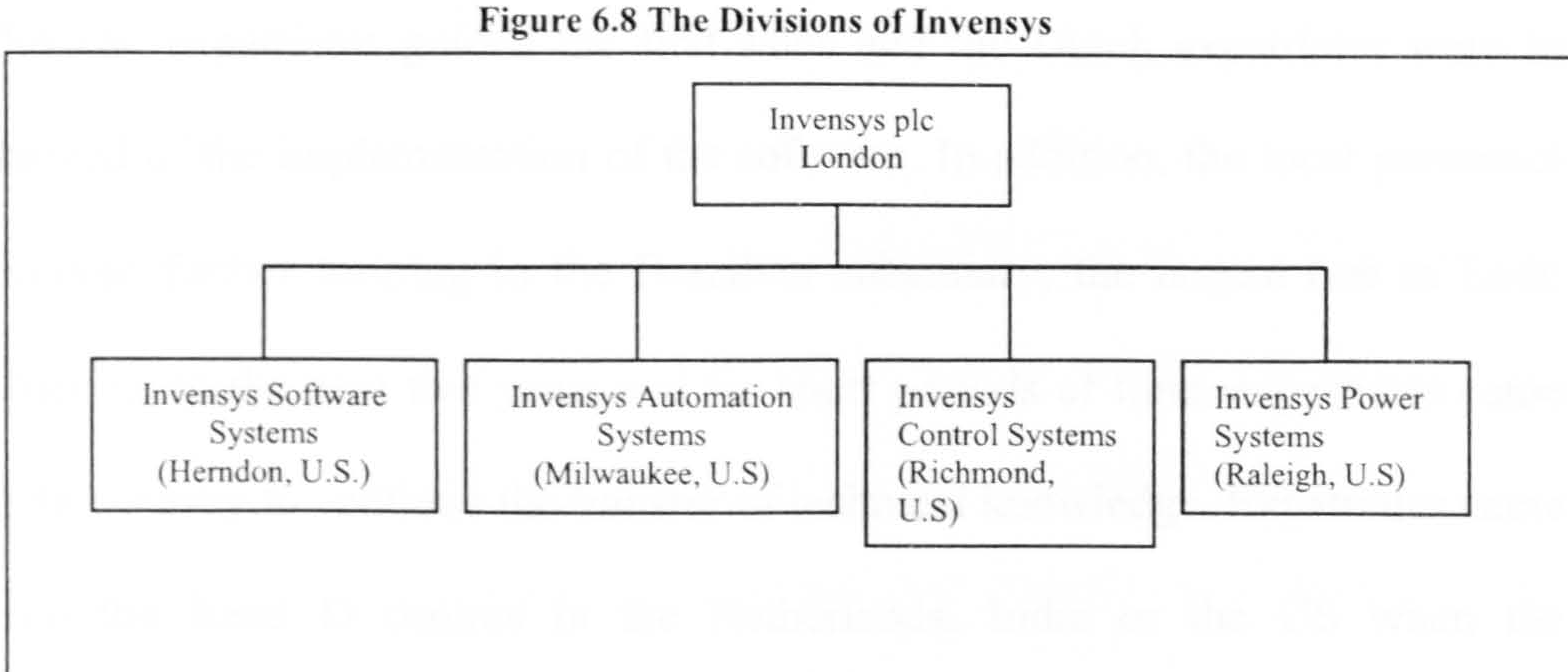
Figure 6.7 Distribution of Invensys Workforce by Regions (per cent)



Source: Invensys (2002).

The new organisational structure adopted a multidivisional form, with its corporate headquarters in London and four divisions located in the US that serve global markets. Figure 6.8 shows the four divisions of Invensys and their locations.

Figure 6.8 The Divisions of Invensys



Source: Invensys (2002).

Invensys's acquisition of Baan caused additional job cuts and cost reductions. In order to support the new reorganisation, the administrative activities of Baan Company were merged with the administrative operations in the Software Division of Invensys under the scheme of a shared structure.

The acquisition of Invensys changed again the Baan's organisational structure. The corporate offices in Virginia were closed, and the offices in the Netherlands became the only corporate offices that reported to Invensys Software Division in Virginia in the US. The sales and marketing activities, because of their specialised nature, were not integrated with other Invensys areas, as happened with the rest of Baan administrative functions.

6.10 Baan Venezuela

BV was a fully operating subsidiary in 1995. The process of setting up the subsidiary was part of Baan's decision to expand into Latin America. The start-up of the subsidiary was similar to SAP through expatriates, from Mexico and The Netherlands, although the general manager of the subsidiary was local. The Mexican expatriates guided the first sales and the Dutch expatriates were in charged of the implementation of the software. In addition, the local personnel received further training in the Brazilian subsidiary, the largest one in Latin America. In the next two years and for short periods of time, expatriates came to the country to continue the transfer of technical knowledge. Expatriates came from the Rand D centres in the Netherlands, India or the US when the knowledge transfer was technical, and when it was linked to other activities such as sales, the expatriate came from other Latin countries such as Mexico.

The expatriates were not seen as a mechanism of direct control. According to the view of a Venezuelan manager they were more a resource for technical training and support for the sales and the implementation of the software:

> *We never used the definition of expatriates. The expatriates were in the US. What we did was to send the Latin America subsidiary managers to Miami because we decided that Miami was the strategic place to manage the relationship with Latin America, but expatriates in the subsidiaries, we did not have that. We carried out knowledge transfer activities through them but they were very specific. To move someone from the US to manage a subsidiary was very uncommon.*

Similar to SAC the subsidiary was managed by local people. The activities of the subsidiary, sales and services, rely on a strong knowledge of the local market. For an expatriate manager was more difficult to carry out these activities because of their lack of interaction with the local context. Local managers were more fit because of their cultural proximity to perform the main activities of the subsidiary.

6.10.1 Baan Venezuela Subsidiary: its Market Position and its Evolution

Baan's strategy to enter the Venezuelan market was to sell software solutions in the sectors where the company had expertise. The limited diversification of the Venezuelan industrial sectors concentrated the operations of Baan in two sectors: a) industrial equipment and machinery and, b) the automotive sector.

The small and medium sizes of Venezuelan enterprises were attractive for Baan, which had developed a strategy of growth concentrated in this sector.

Baan Venezuela in its first years of operations was concentrated on local markets. Its role was as an implementer, which adapted the software to the needs of local firms. Nevertheless, in the subsequent years Baan Venezuela performed better in term of sales than its counterparts in Colombia and Peru. A subsidiary charter extension (Birkinshaw and Hood, 1998) occurred and the Centro America and the Caribbean markets were assigned to the Venezuelan subsidiary.

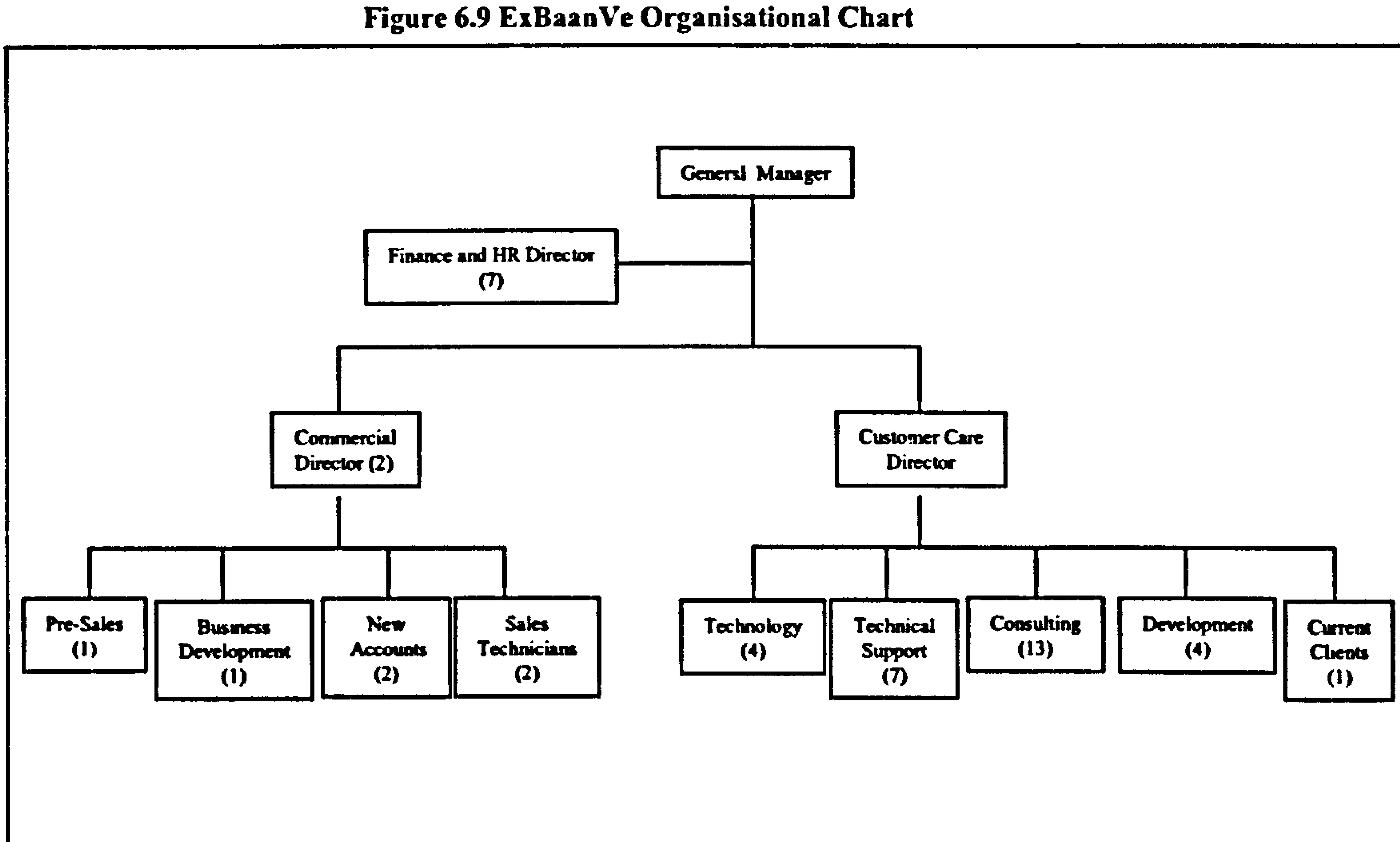
However, the reorganisation and downsizing of Baan affected the operations of the subsidiary. The subsidiary was not profitable enough to justify FDI in the country according to the reorganisation plan of Baan. In 1999, Baan withdrew from direct involvement in the country and a divestment occurred. It sold off the right to sell and service Baan products to the top management of what had previously been Baan Venezuela. This new entity (called here exBaanVe) had a profit-sharing agreement with Baan based on revenues from sales, up-grade versions and support activities.

The evolution of BV has been affected by numerous changes inside and outside the subsidiary. First, the strategy of growth in Baan has been erratic, and its expansion in markets and products had a lack of coordination, which affected the support of the MNC to its subsidiaries. Second, the absence of large users of the software, which could generate attractive revenues, influenced the decision to divest the subsidiary. In the words of a subsidiary manager:

> *I think we have a recession and the ERP boom is gone. We are moving to another type of software. I believe that Baan Venezuela did not have all the expertise to be in the market, to group a number of well-trained people, to sell the product and to give service to a group of customers.*

Currently, ExBaanVe is focused on service activities rather than the sale of the software. This strategy can be observed in the increase in the headcount of the customer care department, which is responsible for the post-sales service. Figure 6.9 shows the larger dimension in terms of employees of the services department compared to the sales department in exBaanVe.

Figure 6.9 ExBaanVe Organisational Chart



Source: Finance and HR Department in ExBaanVe.

Despite exBaanVe new status since 1999, the distributor needs to be in contact with corporate offices and other subsidiaries because of the constant flows of new products and the need to up-grade information on current ones. Invensys after the acquisition in 2000 has left some old mechanisms and implemented new ones to control the operations of exBaanVe. The next part discusses the control mechanisms in exBaanVe and the effect that Invensys acquisition has had on them.

6.11 Output Control Mechanisms in ExBaanVe

The main control on exBaanVe is through activities that generate revenues to the MNC: for instance, software sales and support activities. In addition, the global character of the industry and the geographical dispersion of Baan also create pressures to control the quality of the service offered by exBaanVe to clients.

ExBaanVe has implemented a set of financial controls, particularly to follow up the revenues from the sales of software and support activities. ExBaanVe has to send sales reports every quarter to Baan regional offices for South America. Furthermore, exBaanVe sends sales forecast every month to check the progress on achieving the targets of the business plan elaborated at the beginning of the year. The distributor also sends invoices of the software sales and payments from clients for support activities to the regional offices. Baan before the acquisition, as a public firm in Anglo-Saxon markets, was under strong pressures to implement mechanisms to control financial operations and report on quarterly basis. This type of control has become even stronger after the acquisition by Invensys. In the words of the Vice-president for the region:

> *Before* (the acquisition), *we had more flexibility. We had the possibility to make agreements, for instance, in credits to clients. Invensys is stricter in the management of the client's accounts, and the distributor* (exBaanVe) *has little margin to manoeuvre. Now, the distributor has to be honest about what it can and cannot do. Before, the distributor could say: let's see if this business can generate some profits. And if during this process the distributor had some cash problems, Baan could help it. Today, it is not so flexible: today you need to work closer, it needs to have a more realistic dimension and has to be focused on what the business really is.*

A more Anglo-Saxon style creates more pressures to meet sales targets and make payments on time. ExBaanVe needs to be more accurate in its sales planning and its financial planning to fulfil these demands. Invensys places more demands on exBaanVe to achieve planned revenues, so, the forecast for sales needs to be more accurate and bill payments need to be on time.

The other type of output control is over the service provided to the users of the software. The global nature of the software business industry demands strong homogeneity in the quality of this service. There is a regular report to check the response rate of exBaanVe to clients. There are also activities carried out by centres in the US and the Netherlands to obtain feedback from the users on the service provided by the distributor. The support activity is shared between exBaanVe and Baan: the former provides support for certain requests from clients and Baan offers the service for more complex demands. The fees paid by the clients go to the entity that gives the support.

6.12 Bureaucratic Formalised Control Mechanisms in ExBaanVe

ExBaanVe, in spite of its independent character, relies on standard methodologies in the technical area. The distributor follows templates developed by Baan in the areas of sales, support, implementation and consultancy. ExBaanVe has a considerable number of standard procedures in the technical area in which global homogenisation is important. However, the standardisation is not in such detail as it is in the case of SAC: for instance, there is a general methodology to implement business solutions, which is adapted according to the circumstances and the specificities of the software. There is information about software specifications and sales strategy for specific products, and also there is a set of standard activities for the support services. A local manager describes the levels of standardisation in the technical area like this:

> *You review a product, and search for a client, then, you study how to make the match, what procedures you need. We need to identify every thing to make the product works. One this is done, they give the software solution to us and say: this works like this, the way to sell it is this, the type of support is this, this is the legal agreement, so go and sell it.*

The administrative area has little standardisation: some procedures particularly in the financial area are followed according to Baan standards. Other areas such as consultancy have internal procedures developed locally. In the areas in which there are not global demands, Baan allows exBaanVe to choose its way to operate.

6.13 HR Practices and Policies in ExBaanVe

The HR area in exBaanVe has a more operative nature than a strategic one. There is not a HR department: instead, the finance area is responsible for the HR activities in the distributor. There is a full localisation of these practices: in many cases, they are not formalised. For instance, the performance evaluation plan and the job descriptions of the different positions are developed locally with no input from Baan. The selection process has no formal criteria: experience in the software is the main attribute, which influences the selection. The former employees of Baan Venezuela fill the managerial positions. There is a career plan for employees who can be promoted to higher positions. However, the small size of exBaanVe does not offer many possibilities for vertical promotion, and to move horizontally is the option for most middle managers. There is a variable compensation plan for the technical area, which has been developed locally. The HR practices in exBaanVe are very similar to the HR practices in Venezuelan firms, as was discussed in Chapter 3. Technical training is fully integrated with the activities carried out in Baan. There is a strong link between the two organisations regarding this matter. On the other hand, managerial training is fully localised and independent from Baan control.

6.14 Expatriates as a Personal Centralised Control Mechanism in ExBaanVe

In exBaanVe, the presence of expatriates as a direct control mechanism is rare. Expatriates come on short visits to discuss technical issues, especially to review activities in the support and consultancy areas. When some technical expertise is required to support a sales activity, the exBaanVe has to pay a fee to Baan for those services. Another type of expatriate control is through the monthly visits of the indirect sales operations director for Latin America, to have an update on the sales activities of the distributor.

The reasons for the low presence of expatriate mangers are associated with the activities of exBaanVe. A deep knowledge of potential clients and local business practices is very important for the main activities of ExBaanVe: sales and marketing. It is difficult for a foreign person to understand local markets in a short period of time. Local personnel in charge of the operations offer a better chance to handle the relations with local customers.

Although there are high levels of autonomy in managing the operations of the distributor, there is consultation on certain decisions that might affect the revenue of Baan. The exBaanVe must ask the regional offices for authorisation to on discounts on the prices of the software for potential clients. In addition, the distributor can hire resellers in Central America and Caribbean countries in which exBaanVe does not have sale offices; however, to make an agreement with a reseller the Venezuelan distributor needs to ask for authorisation.

6.15 Control through Socialisation and Network Development in ExBaanVe

There is not a strong presence of these mechanisms in exBaanVe. The need for integration in the technical area is reflected in a frequent consultation on information about support activities, product specifications and enquiries on after-sales services. These activities have helped to develop an informal network with people in subsidiaries of Baan. As a socialisation mechanism, there is an annual corporate meeting with other distributors in the America region to present the new products and services. The frequent innovation in the business software sector makes it important to update corporate guidelines regarding the sales of new products and new services to clients.

Table 6.2 presents a summary of the main control mechanisms in exBaanVe. As a first point to highlight is that the existence of the control mechanisms in the subsidiary is strongly shaped by the character of distributor of the local unit. The more distant relation of a distributor compared with subsidiary is less demanding in terms of control. This explains the existence of few controls through socialisation and networks compared with the other British MNC and SAP.

Table 6.2 Summary of the Control Mechanisms in exBaanVe

Type of Control Mechanisms	*Control Mechanisms in British MNCs*	*exBaanVe*
Output Control	**High**	**High**
Bureaucratic Formalised Control	**High**	**Medium**
HR Practices and Policies	**Strategic and global**	**Operative and local**
Personalised Centralised Control	**Low**	**Low**
Control by Socialisation and Networks		
1. Socialisation	**Medium**	**Low**
2. Informal exchange of information	**Low**	**Low**
3. Formal lateral relations	**High**	**Medium**

Secondly, the Anglo-Saxon origin of Invensys is perceived in the stricter financial controls in the distributor. The demand for short-term results, as has been mentioned, creates more pressures for accurate sales forecasts. Finally, there is a stronger country of operations effect in exBaanVe compared to the other case studies. This can be seen in the nature of the HR policies and practices and the medium presence of bureaucratic formalised controls in the distributor. As the link between the local unit and the MNC is weaker, the effect of the country of operations becomes more powerful creating more pressures for localisation.

6.16 Conclusions

The discussion above of the cases from the business software industry highlights the complexity associated with the study of the implementation of control mechanisms in MNC subsidiaries. The country of origin is still an important effect in the implementation of control mechanisms in the subsidiaries and other features of MNCs. For instance, SAP late internationalisation and still its concentration of operations, of employees and Rand D activities in Germany are evidence of this. In the case of the German MNC, the implementation of practices with a more Anglo-Saxon character has to coexist with other practices with still follow a German pattern. The German MNC shows a hybrid nature in which elements from the country of origin and from other origins interact and shape the operations of the MNC and its subsidiaries. The more hybrid nature of SAP is also evidence that some changes are occurring in the German institutional context that allows German firms to adopt practices that are not German in their origins. The country of origin effect is also present in the case of exBaanVe and the tighter financial controls that Invensys has imposed in the distributor.

Finally, the effect of the country of operations is also evident in the operations of the two business software units. As has been discussed it creates pressures on MNC subsidiaries to adapt their operations and products to the local context. In the two cases its effect is seen in the need to adapt products, services and practices to local demands and local institutions. For instance, SAC has localised products and has also developed control mechanisms to deal with local circumstances. In the case of exBaanVe, the effect is even stronger because the weak link of the distributor with the MNC that creates room for a stronger country of operations effect. In the next chapter in which the comparison of the four cases is made this points are discussed in more detail.

Chapter 7: The Origin of Control Mechanisms in MNCs a Comparison across Countries

7.1 Introduction

The aim of this chapter is to compare the presence of control mechanisms in the MNC subsidiaries. The presence of these devices in the subsidiaries shows the interrelation between distinctive elements belonging to the country of origin of the MNC, country of operations of the subsidiary, and other features linked to the type of industry and the firm.

In order to capture the complexity of the implementation of control mechanisms in MNC subsidiaries, this thesis has focused its analysis at subsidiary level, which is the unit of analysis of this research. The factors selected to explain the existence of a particular set of control mechanisms in MNC subsidiaries are laid out in the analytical framework presented in Chapter 1.

The chapter is divided as follows. First, it presents the analysis of the main characteristics of the case studies. Using the dimensions of control mechanisms presented earlier, the second section compares the output control in the four subsidiaries. Third, this section compares the level of standardisation as a form of bureaucratic formalised control. Fourth, the analysis of the HR practices and policies implemented in the MNC subsidiaries is discussed. Then, this section focuses in the presence of expatriate managers as personal centralised control in the Venezuelan subsidiaries. The last type of control mechanism, control through socialisation and network development, is also compared in this section. Finally, the main conclusions of the chapter are stressed.

7.2 Main Characteristics of the Case Studies

This section will present and compare the main characteristics of the case studies, to facilitate the later comparison of the control mechanisms in each subsidiary. A full description of each case is incorporated in Chapters 5 and 6, in which the cases have been grouped according to their industry of operations.

7.2.1 The German MNCs and their Subsidiaries

This sub-section contrasts the most important features of the MNCs from a German origin with operations in the business software and oilfield service industries respectively. Table 7.1 lists and compares them.

The comparison of the two German firms highlights the existence of some similarities and differences. The similarities can be explained by the effect of the country of origin, which influences the path taken by the firms. For instance, the composition of the boards shows considerable attachment of the two MNCs to the German context, with the presence of the cofounders on the boards in SAP AG, and the election of a CEO with strong connections with one of the main shareholders in the case of Preussag AG.

Table 7.1 The Main Features of the German MNC Case Studies

SAP AG	Preussag Energie
Industry: Business Software	*Industry:* Oilfield Service
Number of Employees: 29,610 employees (43 per cent concentrated in Germany)	*Number of Employees:* The conglomerate has around 69,000 employees (34 per cent concentrated in Germany). The energy division has 700 employees
Ownership Structure: There is combination in the ownership of shares between cofounders of the firms and institutional investors (mainly from the US)	*Ownership Structure:* Mainly institutional investors from Germany. A large participation from a German financial provider
Composition of the boards: Presence of the cofounders in the supervisory board and one cofounder CEO until 2001	*Composition of the boards:* Representation of the different stakeholders of the firm on the supervisory board. The current CEO was a former employee of the German financial provider, one of the major shareholders of the group
International Expansion: SAP was founded in 1972 and its internationalisation was initiated in the late '80s	*International Expansion:* The group was founded 1959. Its internationalisation started in the late '90s
Organisational Structure: Evolution from a global structure towards an international structure with the decentralisation of some operations	*Organisational Structure:* A multinational structure with decentralisation of decisions to exploit local opportunities

The late internationalisation in the two MNCs is a similarity which can be explained according to the country of origin of the firms, as was discussed in Chapter 3. However, there are other features of the MNCs that show attempts to be less attached to their home base and follow a more global strategy. In the case of SAP AG, the evolution of its organisational structure with a decentralisation of operations is part of this. In the case of Preussag AG, its internationalisation, with an increasing concentration of its workforce outside Germany, is another way to become a more global company.

The subsidiaries of the two German MNCs have characteristics which are a combination of the effect of the parent country and the country of operations. These are presented in Table 7.2.

Table 7.2 The Main Features of the German MNC Subsidiaries

SAP for the Andean Region and the Caribbean (SAC)	Preussag Energie Venezuela (PEV)
Size: 160 employees	*Size:* 280 employees
The entry strategy: The MNC opened a subsidiary after obtaining a contract with the largest local firm (*PDVSA*), looking to expand operations in neighbouring countries	*The entry strategy:* The MNC entered the country by making the lowest bid in the third round for the concession of an oilfield
Range of operations: Regional (Venezuela, Colombia, Peru and Puerto Rico)	*Range of operations:* Local (Venezuela)
Subsidiary Role: An implementer (it adapts to local needs software products developed somewhere else)	*Subsidiary Role:* A miniature replica (the development of a set of value-adding activities in the subsidiary). However, technology to operate the fields was imported from abroad
Evolution of the Subsidiary: Subsidiary-driven charter reinforcement has occurred in the subsidiary. The main activities in the Venezuelan unit, sales and marketing, have been reinforced with the responsibility of other offices in the region	*Evolution of the Subsidiary:* A decrease on the investment in the subsidiary occurred with a cost-reduction program in the subsidiary. It can be considered a parent-driven divestment strategy

The entry mode of the two German MNCs to Venezuela shows a cautious strategy to enter the country, which might be explained by the unfamiliar nature of the Venezuelan context to the German firms. As was highlighted in Chapter 3, they had tended to focus their foreign operations on familiar contexts such as Western Europe with little expansion to other more dissimilar environments.

Other characteristics of the German subsidiaries are explained by the characteristics of the country of operations. The two subsidiaries followed different paths in their operations in the country. One has grown in its activities and responsibilities, and the other has decreased in its value to corporate offices. In this evolution, the subsidiaries have developed a set of capabilities that have had different value for the two MNCs. In the case of PEV there is an important influence of institutions of the country of operations, such as the state in the development of capabilities in the subsidiary.

As was discussed in Chapter 3, the institutional environment is a key factor that may shape the development of capabilities in the MNC subsidiaries. In the case of the Venezuelan state, with its interventionist policy on the management of the oil reserves, it has played a leading role on the type of capabilities developed by the oil subsidiaries. The lack of a stable policy to develop this economic sector does not create incentives for PEV to continue with the investment in the subsidiary. In addition, the weak regulatory framework in the country does not offer enough protection to the initial agreement signed between the German oil subsidiary and *PDVSA*.

The institutional regime in the case of Venezuela has created constraints on the development of capabilities in the subsidiary despite its strategic value for the MNC. The behaviour of *PDVSA* reflects the impossibility of the Venezuelan state to provide a stable and predictable environment. It affects the behaviour of the firms (local and foreign) in the country that search for high profits in order to overcome the difficulties associated with operating in these environments. When it is difficult to achieve this, the strategy of the corporate offices towards the subsidiary may be modified.

The case of SAC is slightly different. In spite of the limitations of the institutional environment and the small size of the Venezuelan market, the German subsidiary has managed to increase its value for SAP. In the case of this subsidiary, its interaction with local institutions is less tight than in the case of PEV. The bonds are not so close. The weakness of the educational system to provide personnel with the adequate skills is solve with the internal training developed by the MNCs. The type of relationship between SAC and its clients acts as a mediator in the absence of a strong regulatory environment. The need of SAC to rely on the regulatory system to manage the relationship with clients in the case of default of the agreement is less strong.

An important point to highlight is that MNC subsidiaries interact in a different way with the institutional environment of the country of operations. The level of this interaction will have different effect on the influence of the context in the operations of the subsidiary. When this interaction is more frequent the effect of the institutional environment on the operations of the MNC subsidiary will be greater. When this interaction is less frequent, the effect of the institutional environment will be less strong.

7.2.2 The British MNCs and their Subsidiaries

In the case of the British MNCs, there are similarities in the two firms that can be explained by the country of origin. For instance, the internationalisation of the firms, looking for a fast expansion in one case and in the other to invest in low-cost environments is a strategy which reflects the short-term orientation of British firms. In addition, in the case of Lasmo and Baan, there is a clear separation between management and ownership. Table 7.3 illustrates the main characteristics of the two British case studies.

Table 7.3 The Main Features of the British MNC Case Studies

Baan	Lasmo
Industry: Baan (business software)	*Industry:* Oilfield Service
Number of Employees: Baan: 4,835 employees (1999) Invensys: 96, 519 employees (46 per cent concentrated in the US)	*Number of Employees:* 750 employees
Ownership Structure: Invensys (British Engineering Group held 82 per cent of the shares of Baan)	*Ownership Structure:* 88.57 per cent in the hands of Anglo-Saxon institutional shareholders and the rest held mainly by the directors of Lasmo
Composition of the board: The management team of Baan is mainly composed of Baan employees with the exception of the financial, marketing and technology positions who are personnel of Invensys	*Composition of the board:* The board of directors has a number of independent people, who come from larger oil MNCs such as BP and Shell. The rest are former employees of oil firms acquired by Lasmo.
International Expansion: Early and accelerated through acquisitions of other technology firms and the set up of subsidiaries	*International Expansion:* Early looking to invest in low-cost environments
Organisational Structure: An international model from the beginning of its FDI, after the acquisition, a multidivisional organisational structure	*Organisational Structure.* A multinational structure with decentralisation of decisions to exploit local opportunities

The British subsidiaries show a more risk-taking style compared to their German counterparts as is presented in Table 7.4. The modes of entry to Venezuela of Baan and Lasmo are less risk- adverse and they are oriented to growing fast and achieving results in the short-term. In the case of Baan opening subsidiaries to enter the market without setting up previous agreements with clients. In the case of Lasmo offered the highest bid of the *"Apertura"* to obtain the oil field.

Table 7.4 The Main Features of the British MNC Subsidiaries

BaanVe	Lasmo Venezuela
Size: 105 employees (the current size of ExBaanVe the local distributor)	*Size:* 279 employees
Entry to the country: Baan opened a subsidiary before drawing up contracts with profitable customers, concentrating on small and medium companies. A subsidiary focuses only on the Venezuelan market; other subsidiaries were opened for neighbouring countries.	*Entry to the country:* The MNC entered the country making the highest bid in the third round for the concession of an oilfield
Range of operations: Venezuela and afterwards the Caribbean. In a later stage, it became a local distributor (ExBaanVe)	*Range of operations:* Local (Venezuela)
Subsidiary Role: An implementer (it adapts to local needs software products developed somewhere else)	*Subsidiary Role:* A miniature replica (the development of an entire set of value-adding activities in the subsidiary).
Evolution of the Subsidiary: A subsidiary-driven charter extension (with the expansion of operations to the Caribbean) and then a parent-driven divestment (the change on the status of the subsidiary to a distributor)	*Evolution of the Subsidiary:* A cost-reduction program was implemented in the whole company. However, it can not be considered a parent-driven divestment strategy regarding Lasmo Venezuela

The subsidiary role in the case of the four subsidiaries has been mainly implementer. In the case of the oil subsidiaries, a set of activities in the area of exploration and production was developed by combining the knowledge of the oil MNCs with the local expertise. However, this knowledge developed locally did not change the role of the oil subsidiaries. It seems that the Venezuelan institutional context influence greatly in this matter. The lack of opportunities to increase the operations of the subsidiaries did not support a more strategic role of them for the oil MNCs.

SAC is the only case of the four that has increased its charter. By contrast to BaanVe, the German subsidiary has increased its value to corporate offices. The local management team found options to deal with the difficulties of the Venezuelan context and increase the range of their operations. BaanVe shows an opposite picture with the decreased value of the subsidiary and followed by its change to a distributor. The behaviour of the subsidiaries shows a different response by the local management of the local units to the same context. These two cases present a less deterministic view on the effect of institutions on the operations of firms. There is the possibility of strategic action by local managers which in turn may mediate the effect of institutions on the operations of firms. There is room for manoeuvre for strategic action which can influence the fate of the subsidiaries and how they decrease or increase in strategic value for the MNCs.

The next section, analyses the presence of control mechanisms in the subsidiaries according to type, with special emphasis on the forces which influence their existence.

7.3 Control Mechanisms in MNC Subsidiaries

This section compares the different control mechanisms in the MNC subsidiaries. The classification to make the comparison of control mechanisms was presented in Chapter 1. The control mechanisms are an interesting topic to study the effect of the country of origin and country of operations on the activities of the MNC subsidiaries. They reflect organisational characteristics such as how organisations are configured. As was discussed in Chapter 3, this configuration is highly influenced by the institutional context. The classification has four categories: output control which is mainly related to financial controls, bureaucratic formalised control associated with the standardisation of procedures, norms and rules, personalised control linked with the presence of expatriates in the MNC subsidiaries, and control by socialisation and networks which are subtle and informal forms to control operations. In addition, the research contemplates HR policies and practices as another means to control operations in MNCs. The review of the control devices in the MNC subsidiaries follows the previous classification and presents them by group of firms according by national origins.

7.3.1 The Comparison of the Output Controls in the MNC Subsidiaries

Output controls focus on the behaviour of individuals. Financial targets achieved and financial reports filled by different areas of the organisation represent them. Planning and budgeting activities are also in this category. Following the typology developed in Chapter 3, the type of output control in the German subsidiaries shows differences from the initial propositions of few financial controls in German subsidiaries. The case of the British subsidiaries is more consistent with the initial proposition of strong reliance by British firms on financial controls. These findings are now explained in more detail.

7.3.1.1 The German MNCs: The cases of SAP AG and Preussag AG

In the cases of SAP AG and Preussag Energie, the demands of the shareholders and their expectations are reflected in the characteristics of the financial controls in the two companies.

In the case of PEV, the financial controls implemented by the subsidiary were set up to legitimise decisions and actions that had already occurred rather than to control future management performance and outputs. The considerable proportion of German investors, who share fewer expectations for short-term results, is reflected in the weakness on these controls to align the performance of subsidiary with short-term results. This is also reinforced by the fact that Preussag AG is only listed on the Frankfurt stock market. Thus, the pressure to use the financial controls as a mechanism to align performance and behaviours with the strategy of the firm is less strong.

However, in spite of the embeddedness of the financial controls of PEV on the German context, there are indications that the MNC is looking to implement financial controls, more oriented to monitor performance in the short-term. The introduction of a management programme, with the aim of: monitoring costs, improving profitability analysis, and eliminating the duplication of reports, demonstrates changes in the MNC financial controls.

The reorientation of financial controls may be linked to the radical change in the core activities of Preussag AG, which is searching for more profitable business due to the decline of its "old core business". The strategy of the firm is to enter the logistics and tourism businesses and this implies a significant change in the location of the MNC's operations, with a notable redistribution of the workforce abroad.

SAC, the subsidiary of SAP in Venezuela, presents a different picture compared to Preussag Energie with a more Anglo-Saxon orientation in its financial controls. The relationship between the Venezuelan subsidiary and the reporting centres in the US and Germany are characterised as having strong controls over the operations of the local unit. There is a close monitoring to meet sale targets and to be cost-efficient. Managers in the subsidiary face strong pressure to meet quarterly profits by meeting sales targets or carrying out cost reductions.

SAP AG lists its shares on NASDAQ and Frankfurt stock markets to obtain funds from these resources and be more independent of the pressure of German banks. To be listed in an Anglo-Saxon stock market implies to make public its financial activities and following the accounting standards that these markets set. The consolidated financial statements of the MNC are prepared in accordance with U.S. GAAPs (SAP AG, 2002). Investors in the Anglo-Saxon markets such as NASDAQ focus on financial performance and markets, which is reflected in the share price. SAP AG has to monitor this carefully and ensure that it keeps its share price up; otherwise it will raise its cost of borrowing and make itself subject to a possible takeover. As part of this process, the subsidiary is pressured to be as a cost-efficient as possible and to be accurate and positive in profits and forecasts.

Overall, the two German companies show a process of becoming more international and less dependent on Germany in sales growth, number of employees and profits. The rationalisation of costs together with the search for cheap capital, new investors and business opportunities seem to be drivers behind the internationalisation of the two companies. Although SAP AG still has a significant proportion of its workforce in the home country (43 per cent), a recent announcement by the company that it will double its workforce in India in the next three years shows a tendency to continue to look for low-cost environments and become a more global firm (The Economist, 2003).

The financial internationalisation of SAP AG introduces a more Anglo-Saxon approach to control the financial operations of the firm. As Beyer and Hassel (2002) argue, firms with a higher degree of financial internationalisation can expect to have investors that are looking for a higher portion of the net added value generated by the firm. This value is transferred to dividends and share growth, and away from wages.

Although SAP AG shows traces of a more Anglo-Saxon approach in its financial operations, the composition of the company board presents vestiges of the home country influence, with the cofounders continued to manage the company directly until 2001 since then indirectly through their presence in the supervisory board. There is a "hybrid effect" with the coexistence of an Anglo-Saxon style in the search of funds and a "German way" to have family-managed enterprises.

In Preussag AG, the board of the MNC has a more typical German composition with the participation of the different stakeholders and the linkage of the CEO to one of the main German banks and provider of other financial service, which holds shares in the firm.

The two firms show traces of hybridisation with the combination of practices that are still embedded in the German context and the adoption of others, which are imported from other BSs. The introduction of the concept of shareholder value in German companies is a subject of increasing debate (Lane 2005; Jackson, 2003; Hassel et al., 2003; Beyer and Hassel, 2002; Jürgens et al., 2000; Peck and Ruigrok, 2000;Vitols et al. , 1997). The debate involves positions which range from a weak adoption of the role of shareholder value in German companies (Jürgens et al., 2000) to the other extreme, which argues that structural changes in the German national business system are the origin for transformations in the corporate governance of German firms (Lane, 2005).

Vitols (2003) has argued that there is a reorientation in the business strategy of large German banks in the direction of US style investment banking. The author argues that there is "hybridisation" in the German financial system with a split in two segments: one that is more liberal and serves the need of large firms, and another for small and medium-size companies. The effect on large firms is that there is a reorientation of the preferences of German banks and insurance companies, for instance, towards a profit-oriented portfolio of companies. Domestic institutional investors are expanding dramatically in Germany because of the changes in the taxation rules such as the "Eichel" laws and the restructuring of pensions schemes. These new investors are likely to change the way in which firms relate to their shareholders. They will create more pressures for short-term results in the companies that should be reflected in the price of shares.

Some authors are arguing that there is a hybridisation of the German model (Streeck and Yamamura, 2003; Vitols, 2003; Jackson, 2003), and they are refracted in changes of national institutions and in modifications in the role assumed by social groups. This hybridisation is reflected in the coexistence of features from the old model with other from the new model. SAP AG is an example of this, with its pressures for short-term results and a weak separation between ownership and management.

As Jackson (2003) has described it, there are changes in the German institutions that have affected the rules of the game and the strategies of major actors, taking them away from the traditional model. A hybrid model is emerging, which combines traditional features from the country of origin and new features, which are the reflection of changes in the institutions. These changes allow the incorporation of practices imported other contexts, for instance, the adoption of financial controls with a more Anglo-Saxon orientation.

The comparative analysis of the financial controls in the German subsidiaries shows that there are changes in the institutions from the country of origin which in turn are affecting the management of the German MNCs. A finding of this research is that institutions are exposed to change, which is reflected in the management of firms from a specific origin. A less static approach has to be incorporated in the analysis of the effect of institutions in the firms' management. This research has assumed a more static view of institutions looking at them as monoliths which were not affected by time and history. As Morgan (Morgan, 2005) has stated a more dynamic view is needed for the study of the effect of institutions on firms. They are subject to change and realignment. During this process, their demands on firms may vary altering the internal operations of organisations as this research has shown.

7.3.1.2 The British MNCs: Lasmo and Baan

As can be expected, the financial controls in firms from a liberal market economy, as is the case of the Lasmo subsidiary in Venezuela, are sophisticated mechanisms to control the financial operations in the MNC subsidiaries. Lasmo presents a variety of financial mechanisms to control the Venezuelan subsidiary: a permanent monitoring of the subsidiary performance in terms of profit, cost and return on the investment is carried out from corporate offices in London.

Lasmo shareholder structure shows a typical Anglo-Saxon pattern with a large proportion of institutions holding shares. From its origins the MNC has had considerable dependence on Anglo-Saxon capital markets. The company has to produce short-term results through quick profits to fulfil their demands, and the financial controls play an important role to achieve this objective.

The case of ExBaanVe shows a more complex picture because of the changes in the ownership structure of the MNC since the company was founded and the changes in the subsidiary. Baan was founded in The Netherlands as a small software firm that became a Dutch MNC and ended as part of a British conglomerate. The ownership structure of Baan has changed, affecting the financial controls deployed in the company. In the early stage of its operations, the firm followed the typical pattern of Dutch firms, which are characterised as having a medium size and using credit funding to finance their short term needs. Iterson and Olie (1994) describe the Dutch banks as specialists in short-term credit provision and trade finance. Other financial institutions, such as pension funds and insurance companies, provide long-term credit.

The second stage, starting in 1993, was characterised by a vigorous international expansion of Baan funded by the investment of US venture capital. This process was facilitated by the well-developed nature of the Netherlands stock market, with high levels of foreign investment. The small size of the domestic market and the strong pressures from the Anglo-Saxon investor, who was looking for short-term results that would reflect in the price of the share forces, create pressures to internationalise rapidly. The subsidiary, BaanVe, was set up during this rapid expansion of the firm. Since the initial operations financial controls with an Anglo-Saxon approach have been implemented to monitor revenue from sales and support activities, and generate quarterly reports.

The third stage implied a radical change in the shareholder structure of Baan, when Invensys acquired it. The new shareholder tightened the financial controls in general and over exBaanVe. In spite of the nature of distributor of the ex-subsidiary, the few financial controls that remained between the two parts were increased. This was expected accorded with the behaviour of Anglo-Saxon investors, as we have discussed above.

It seems than in the case of Britain the domination of the economy by market-driven transactions focused on short-term gains is reflected in the emphasis of British MNCs on tight financial controls. There are sophisticated mechanisms to control the financial operations of firms from liberal market economies, as was explained in Chapter 3. By contrast to the German institutions the British ones have been exposed to fewer forces of change. Therefore, there are not significant pressures to change the nature of the financial controls in British MNCs.

7.3.2 Comparison of Standardisation as a Bureaucratic Formalised Control Mechanism

The aim of making activities and procedures more predictable in a specific direction is the rationale for another set of control mechanisms implemented in the subsidiaries. These controls are in the category of bureaucratic formalized controls. Child (1984) argues that, when organisations grow, levels of decentralisation are desired. Thus, there is the need to develop frameworks of rules and systems within which decision-making can be delegated and predictable results can be obtained, the implementation of mechanisms to standardise operations in organisations fulfils this aim. The strong reliance of German and British MNCs in standardisation to control the operations of their subsidiaries was discussed in Chapter 3. The findings of the four cases support this proposition; however, the level of standardisation in the MNC subsidiaries is mediated by other factors such as the stage of internationalisation of the firms and its organisational structure. The control mechanisms to standardise operations in the MNC subsidiaries are now presented in the next part.

7.3.2.1 The Standardisation in the German Subsidiaries

In the case of SAC, the German business software subsidiary, there is heavy reliance on standardisation of procedures, norms and levels of decision. This standardisation has two dimensions: one level of local standardisation, which involves formalisation of procedures and written policies but only for the subsidiary's operations, and the other more global, with uniformity of procedures and norms among the different units of the MNC.

The differences in the nature of standardisation in the subsidiary, global and local, respond to different degrees of consistency in the operations of the local unit, which are dictated by the organisational structure of the firm. When the firm needs to have a global consistency which facilitates the integration between the subsidiaries to support flows of knowledge and personnel, the standard mechanisms in the subsidiary are implemented following principles that are shared by all subsidiaries, many of them coming directly from Germany. The type of industry of business software creates more demands to standardise procedures, norms and policies in the MNC, as discussed in Chapter 4,. This is particularly relevant in the technical area in which the need to offer the same quality in products and services creates greater demands to standardise.

Standardisation is extensive in SAC, with many templates, procedures, policies and norms imported from abroad, some of them subject to adaptation and other implemented as they come. The number of operations of SAP AG abroad which shows an advanced stage of internationalisation with more than 29,000 employees spread worldwide, brings strong demands to unify operations and make more predictable the outcomes of the units of the German MNC.

PEV, the other German subsidiary, has a mixed picture on the implementation of standard controls. There are few procedures to follow in the technical area, particularly to guide the exploration and production activities. PEV relies on individual knowledge, particularly expatriate personnel, to carry out them. In the operation fields the standard procedures have written recently and they are only to regulate the operations in the Venezuelan field. This standardisation has been on a local basis, integrating international standards, *PDVSA* requirements and PEV experience operating in the urban field.

The administrative area is more standardised with the transfer of some procedures and rules from Germany. However, they have been adapted to the local context to fulfil local regulations. The financial area is also standardised, and there are explicit procedures for carrying out the accounting. The contrast between the two areas, with high levels of standardisation in the administrative area but less in the operative one, is largely explained by the lack of international experience of Preussag in exploration and production activities. The standardisation in the administrative area shows the legacy from the country of origin of the MNC. However, the early stage of the internationalisation of Preussag Energie has not created demands to standardise procedures in the technical area. Expatriates can supply the technical knowledge required in the operations of the MNC abroad because the number of these international operations is small.

We would expect high standardisation of procedures from German MNCs but in the case of case studies of this research is mediated by the internationalisation stage of the MNC and its organisational structure.

7.3.2.2 The Standardisation in the British Subsidiaries

Lasmo Venezuela, similar to PEV, has few standard mechanisms in the technical area. The infant stage of exploration and production activities in the subsidiary, similar to PEV, accounts for the little reliance on these mechanisms.

The financial department, in the administrative area, has global standardisation in procedures, norms and reporting activities. There are written manuals with procedures, reports and explicit financial calculations for investment projects. In other administrative areas such as the HR and security departments, the standardisation is more local.

ExBaanVe, in spite of its independent character, relies on standard methods in the technical area. The administrative area in the subsidiary has weak standardisation of administrative procedures and systems, although, exBaanVe still follows the financial formats inherited from its time as a subsidiary of Baan.

There are similarities in the level of standardisation in the MNC subsidiaries from the two countries. The MNC subsidiaries not matter, if the standardisation is on a local or global basis, show indications of a heavy reliance on standard procedures and written rules to support operations. As was discussed above, there is a tendency of German and British MNCs to depend on this mechanism to control and coordinate their operations.

Overall, it can be argued that the implementation of standard controls is shaped by the country of origin of the MNC, which is tend to reinforce the presence of certain type of controls rather than others. The cases of Germany and Britain are examples of how the country of origin explains the presence of standard controls in their MNCs. However, this influence from the home country is mediated by intra-organisational characteristics such as the stage of internationalisation of the firm and its organisational structure. On one hand, firms with short international experience, either because they have few subsidiaries abroad or they are new to carrying out certain operations internationally, have to learn these activities before they can attempt to standardise operations in those areas. Thus, the tendency for firms to implement standard mechanisms is connected with features of the firm that will support or delay their implementation. On the other hand, certain organisational structures are going to demand more integration in operations than others, and this also shapes the type of standardisation: global or local.

7.3.3 Comparison of the HR Practices and Policies in the MNC Subsidiaries

This section presents the HR practices and policies in the four MNC subsidiaries. In the case of the German MNCs, it is argued that their approach to the function is more operative than British MNCs. The high-regulated environment of Germany explains this. By contrast, in the case of British firms, they have a more strategic approach with the implementation of practices that support the strategy of the firm. The case studies support this argument, showing a country of origin effect in the nature of the function. However, this is mediated by other factors such as the localisation of practices because the country of operations effect.

The HR function in PEV has distinctive characteristics of "Germanness" as was described in Chapter 5. The HR has an operative orientation with the absence of practices such as job evaluation, succession planning and management development. The function does not participate in the top-decision making, the HR function is at third level under the supervision of the administration manager who reports to the finance and administration vice-president (see subsidiary chart, Figure 5.3).

There is a lack of integration of the HR department with the rest of the function in the MNC, which limits the adoption of practices from abroad. In addition, the characteristics of the Venezuelan context, which is highly regulated, reinforces the operative nature of the function in Venezuelan firms. Because of this, this context does not encourage the adoption of practices with a more strategic approach in the areas of selection, training and career development.

SAC presents a different picture, compared with PEV, and has imported HR practices from abroad. The existence of a variable compensation scheme linked to performance, which is designed abroad and coordinated by the regional centres, is evidence of this.

Job descriptions based on competencies, in addition, to the pressures to create a career development program in the subsidiary are further evidence of the adoption of imported practices in the area. Furthermore, the existence of an international career development programme with clear guidelines and procedures shows a more strategic and integrated approach in SAP to managing its human resources. SAP relies on these activities as a subtle way to control operations through the transfer of common patterns (e.g., job analysis) and communication of desired behaviours (e.g., career development programme).

However, there is a country of operations effect because the implementation of these practices in the subsidiary is mediated by the characteristics of the country of operations. Because of the characteristics of the region, the managers of the subsidiary do not participate in the international career development programme of the company. There are limitations for the integration of these managers with the rest of the MNC due to a country of operations effect. The effect, in this case is so strong, that makes more valuable for the MNC to have these managers in charge of the local operations than encourage their participation in an international career development programme.

The country of operations effect is also seen in the adaptation of other HR practices to the local context: the maximum per centages of salary increase which are decided locally, imported job descriptions that are adjusted locally, and the variable portion of the compensation is designed according to the preferences of local managers. Finally, HR practices such as recruitment and selection are designed locally, too.

The analysis of the HR practices in the two German subsidiaries presents evidence of a country of operations effect. In relation to the parent country effect, recent research on German MNCs and the nature of the personnel function in these companies has shown an increasing adoption of practices to support the strategy of companies. The fact that SAP is a step further than Preussag in its process of becoming a global firm may account for the adoption of HR practices with a different nature than the German traditional ones. As Ferner and Varul (2000) posit, companies that have more internationally integrated activities are more likely to face growing pressures for HR practices to be orchestrated more internationally. Global coordination, in theory, demands a more strategic approach to the HR function, to facilitate the integration among the subsidiaries of the MNC. Thus, when the need of the MNC to be integrated is higher, it is going to implement HR practices which are more standardise because these support integration among the subsidiaries, and the subsidiaries and corporate offices, and they also act like subtle control mechanisms in the subsidiaries.

The highly regulated labour market in Venezuela has not impeded the transfer of HR practices, which are different to the practices implemented locally.

Ferner et al. (2001) in an analysis of German companies with operations in Spain, state that the management model of the latter is more open and indeterminate with few management traditions. This lack of a uniform set of local HR practices allows more choices for MNCs to implement imported HR practices in subsidiaries operating in this context. A similar argument can be applied to subsidiaries in Venezuela. In spite of the highly regulated environment that demands adaptation to follow local regulation, there is still room to introduce imported practices. The absence of strong local managerial patterns facilitates the introduction of other managerial practices such as the transfer of human resource policies and practices from abroad.

The Lasmo subsidiary in Venezuela has implemented HR practices, which are more common in Britain. The HR function has a strategic role with the formalisation of many practices in the area such as the development of a formal programme to substitute expatriates by local personnel, and the implementation of a performance evaluation system linked to compensation. The attempt to transfer a stock option program, which is common in Britain, shows the influence of the parent country.

Despite the more strategic role of the HR area in Lasmo Venezuela, which on one hand implies more integration of the subsidiary with the rest of the MNC, and on the other hand, it helps put in place subtle control devices. The demands to adapt to the country of operations are strong in this subsidiary, too. For instance, a stock option plan was adapted to local preferences. A corporate company policy states that local managers are appointed as substitutes for expatriates, but career development has a local ground different to the people in the technical area, which is more international oriented. The country of operations limits the possibilities to have an international career for local managers. They are developed to support local operations rather than to be a cadre of international managers that move around the different sites of the MNC.

The HR function in the exBaanVe is fully localised. There is autonomy to implement the HR practices and policies according to the preferences of the local managers. In this particular case, the parent country effect is minimal.

The analysis of the forces that intervene in the implementation of human resource practices in the subsidiaries shows the complexity of this control mechanism. On one hand, there are forces from the parent country and the organisation itself that shape the nature of these practices in firms. However, when MNCs set up operations in a country they face pressures, which certainly mould the implementation of HR practices in the subsidiaries. The implementation of practices imported from abroad will be easier when there is little uniformity in the HR practices of local firms. In this case, the adoption of imported HR practices will be facilitated as the previous analysis showed.

7.3.4 The Presence of Expatriate Managers as a Personal Centralised Control Mechanism

According to the country of origin debate, the presence of expatriate managers should vary in the MNC subsidiaries. In the case of British subsidiaries, the presence of these managers should be lower compared to German subsidiaries. In Chapter 3 was discussed that German MNCs are distinctive because of their strong presence of expatriates. Nevertheless, the findings from the cases do not fully support this proposition. There are differences in their presence between MNCs subsidiaries from the same origin in different industries. For instance, the oil subsidiaries have expatriates independently of the country of origin. By contrast, in the business software subsidiaries there are not expatriates. The main reason for this unexpected finding is the effect of the country of operations and the characteristics of the two industries in Venezuela. In the next sections, these two effects are analysed in detail.

7.3.4.1 The Presence of Expatriates in the Oilfield MNC Subsidiaries

Lasmo Venezuela, after four years of operation, still has a considerable number of expatriates. Considering the multidomestic nature of the oilfield service industry one might expect fewer expatriates and a bulk of locals managing the relationship between *PDVSA* and the subsidiary. However, there is a slow pace in the substitution of expatriates by locals, particularly in the finance and operative areas. This contradicts what would have been expected: fewer expatriates in the subsidiary because of a country of origin effect. In addition, there are pressures to localise the workforce from the corporate offices (e.g., expatriates' high costs on salary and perks) and from outside the MNC (e.g., Venezuelan labour regulations limit the number of expatriates in MNC subsidiaries in the country).

PEV, the German oil subsidiary, presents a similar picture the localisation has become slower in the last year. It has been difficult for the company to find local people for managerial and technical jobs. In some cases, they had not appoint Venezuelans with the right qualifications for certain positions, creating a lack of confidence in the localisation process of the subsidiary.

The reasons for the presence of expatriates can be explained by the institutional environment in Venezuela and the characteristics of the oil industry in the country. One hand, the nature of the Venezuelan state is reflected in the way *PDVSA* manages the relationship with the oil MNCs. The interventionist role of the state, as has been discussed, is reflected in the changing strategy of the NOC, which in turn affects the demands that *PDVSA* makes on the oil MNCs. On the other hand, the educational system has not trained enough people affecting the localisation of the technical expatriates. The fragmentation of institutions has made it difficult to coordinate job between the educational system and the oil industry. This is reflected in the fact that the former has failed to supply personnel with the qualifications to support the development of the latter.

Furthermore, the BS in Venezuela does not have a strong legal framework to regulate the transactions among economic actors. Therefore, for the oil subsidiaries to rely on this framework to make the NOC fulfils the initial agreement is very difficult. The development of personal networks becomes important to reduce the levels of uncertainty associated with the frequent changes in demands that *PDVSA* makes on the oil subsidiaries.

For PEV has been less difficult than Lasmo Venezuela in coping with the uncertainty of the Venezuelan context. The German subsidiary has found a solution in the middle ground using locals to manage the relationship with the NOC, who are closely supervised by the expatriates in the subsidiary.

Local people are good candidates to act as bridges between the MNC subsidiaries and *PDVSA*. It is more feasible that indigenous people with their knowledge about the local system can more easily interpret *PDVSA* requests and negotiate according to its terms and style. In addition, locals working in the Venezuelan oil industry may have connections in *PDVSA*. Before the opening, the main firm in this industry was the NOC, thus, to know people inside the firm would not be very difficult.

However, the combination of a high level of autonomy for the subsidiaries and the use of informal and personal networks to manage the *PDVSA* relationship created some difficulties for the subsidiaries, which were at least partially resolved by the presence of expatriates. The vulnerability of the MNC because

PDVSA was the only buyer for the production of oil and at the same time is supplier of resources, puts the subsidiaries in a weak position. In turn this makes the corporate offices reluctant to let go of control because failure to manage the relationship satisfactorily would had a serious impact on profitability. Thus, the corporate office was thus averse to decentralise to locals and instead maintain expatriate control.

Expatriate managers in the oil subsidiaries reconcile the demand for local responsiveness with the need for close monitoring of local context. They exert an important role as a mechanism of control in MNCs in a multidomestic industry with operations in unstable environments. Boyacigiller (1990) has pointed out that when a subsidiary is operating in an environment with high political risk the subsidiary has a greater presence of expatriates. Moreover, when there is high information asymmetry between the parent and the subsidiary and significant differences in the information and knowledge held between the subsidiary and the corporate offices, a high presence of expatriate managers is justified (Harvey, Speier, et al. 2001).

In this context, the home country effect is relevant but operates in a distinctive way. British firms generally find it easier to reduce their expatriate numbers than German firms. As the former tends to operate on the basis of output controls (over financial performance) rather than the control through expatriates, which is more common among German MNCs. In this case, however, output controls are ineffective in themselves. They are important to increase economic efficiency on production activities. However, control over the relationship with *PDVSA* has a more strategic value, because in the long term the increased profitability of Lasmo Venezuela production are determined by the relationship with *PDVSA*. Furthermore, British expatriates are reluctant to cede control because there is no clear career for them within the firm once they leave Venezuela. In this respect, they send the message to headquarters about the continued need for expatriates reflecting partly the reality of institutional uncertainty and dependence and partly the insecurity they feel about their own career prospects. It also leaves the corporate offices that is used to evaluating performance on output and financial criteria with a problem because this is no longer satisfactory.

The German subsidiary faces similar uncertainty. However, managers there and in the headquarters seem to experience less anxiety about this for three reasons. Firstly, the existence of the German community within Venezuela seems to provide a pool of potential employees for the firm that can take this intermediary role and provide some access into the appropriate networks. Secondly, German expatriates (unlike the British ones) are strongly tied into the corporate offices. They expect to return there having been assigned abroad for a specified time. Their career is still "German" in key respects and the firm treats them as valuable assets. Their international assignment is a temporary position within a broader expectation of long-term commitment to Preussag Energie. The expatriates in the British subsidiary are, however, more like "career expats" who will have an international career often moving between firms rather than seeing themselves as locked into a particular firm. The close tie between the German expatriate and head office means that the subsidiary managers have more day-to-day autonomy because it is believed they will know the interests of the firm more generally and operate along those principles. Thirdly, the German firms are more used to implementing subtle mechanisms of control such as socialisation, informal communication and the development of personal networks as was discussed in Chapter 3. Therefore, to use these devices to manage the relationship with *PDVSA* is easier than their British counterpart that relies more on formal and impersonal mechanisms such a financial controls to manage their operations abroad (Morgan and Marquez, 2003).

7.3.4.2 The Presence of Expatriates in the Business Software MNC Subsidiaries

The presence of expatriate managers in the MNC subsidiaries in the business software industry is very scarce. In the case of SAC, the managing director of the subsidiary is the only permanent expatriate position. There are short visits from personnel from other SAP offices but they are for short periods of time and to accomplish specific tasks. In the case of ExBaanVe is even scarcer as was discussed in Chapter 6.

There is a technology effect associated with the characteristics of the industry that explains the absence of expatriates in the subsidiaries. There is a lock-in effect that creates a dependency between the user of the software and the business software provider as was explained in Chapter 4. In the case that the client interrupts the payment for software and service, the service provided by the business software firm ceases. The interruption of the service may create serious problems for the operation of the client affecting activities in operative areas (e.g., manufacturing, finance and RH). Then, to breach the terms of the agreement between the two parts is very costly for the business software user. The need to rely on a strong regulatory framework to regulate the transaction between two parts is overcome by the implications for the user if the relationship is broken. The threat of losing the support activities and the upgrading of business software versions acts an incentive to fulfil the business commitments. In the case of the business software subsidiaries, the effect of the Venezuelan institutional environment is less strong on the operations of the subsidiaries as compared to the oil subsidiaries. From the findings of the case studies, it can be argued that institutions do not affect in the same way the firms that are operating in a specific context. There are specific features from the industry and the firm itself that act as mediators on the effect of institutions.

The effect of the Venezuelan institutions and the size of the local markets influence the development of capabilities in the firms, as was discussed previously. It also accounts for the scarce presence of expatriates in control of the local operations. The main activities of the subsidiaries are sales and marketing. It is particularly relevant for people carrying out these activities to understand the indigenous way of negotiating and the threats and opportunities that the local environment creates for firms. For instance, to know the local language, know the business processes in local firms, and understand local regulations are barriers to have expatriate presence. Thus, from a strategic position the MNC has more incentives to support a rapid localisation and limit the presence of expatriates to increase the profitability of the subsidiary. In this case, the implementation of strong financial controls and the frequent consultation on decisions are efficient devices to monitor the operations of the MNC subsidiaries. By contrast in the oil subsidiaries, the financial controls are not efficient mechanisms because there is a different relationship between the local units and the Venezuelan institutional context.

7.3.5 Comparison of Control through Socialisation and Network Development in the MNC subsidiaries

The case studies present evidence of the effect of the country of origin in the implementation of subtle controls. However, the industry that influences the organisational structure adopted by firms is a complementary explanation for the presence of these devices.

7.3.5.1 Subtle Controls on the German Subsidiaries

The German subsidiaries present a mixed picture on the use of subtle controls as a control mechanism. For instance, PEV is a typical German example with the use of socialisation of the expatriates as a subtle way to transfer the organisational culture. However, this is the major subtle way of control in the MNC. The development of informal networks is limited to the networks developed by the German expatriates from the time that they were in the corporate offices. The limited communication between locals and corporate offices offers few opportunities for locals to develop such informal networks.

Other subtle devices are few. There is limited presence of cross-functional teams between the subsidiary and other units. The weak integration between the subsidiary, corporate offices and other subsidiaries is confirmed by the lack of knowledge transfer between the Venezuelan subsidiary and the rest of the firm. Even if the Venezuelan subsidiary has inflows of new technical knowledge from local personnel with previous experience in other oil MNCs, the subsidiary has not made any serious attempt to transfer this to the rest of the firm.

SAC makes a more sophisticated use of these devices. In spite that the firm does not use expatriates as a subtle control, it has implemented other subtle mechanisms. The need for integration because of the global nature of the industry is reflected in the implementation of other forms to support subtle ways of control. The configuration of virtual teams, with members from different subsidiaries is one of these mechanisms. The creation of these teams with people localised in different sites around the world who have to work together are part of this more integrative nature of the firm. There is a strong development of informal networks because of this in the MNC. There is also substantial exchange of information between the Venezuelan subsidiary, other subsidiaries, and regional and corporate offices, which facilitates the development of these networks.

The analysis of subtle mechanisms in German subsidiaries has shown differences in the reliance of the two units on these devices and in the levels of integration between the subsidiaries and their corporate offices. Variations in the nature and extent of subtle mechanisms in firms from the same country are explained by the characteristics of the industry.

Despite the tendency to select control devices according to the MNC country of origin, the nature of the industry reinforces this selection or weakens this primary pattern. The effect of the country of origin on the implementation of control mechanisms is mediated by the characteristics of the industry as was hypothesised.

7.3.5.2 Subtle Controls on the British Subsidiaries

Lasmo Venezuela relies little on socialisation as a mean of control. In an indirect way the expatriates act as a socialisation mechanism but the firm has not developed other subtle controls that is accorded on how British MNCs operate. In Lasmo, expatriates have an opportunity to create informal networks because of their connections with corporate offices and other subsidiaries but locals do not have the same opportunity. In the case of ExBaanVe, the main evidence of this type of control is an annual corporate meeting. There is also evidence of the development of informal networks because of the exchange of information among personnel in the technical area.

The presence of these devices is in accord with what would be expected from British firms. The development of an informal network with people in other sites in the case of ExBaanVe is supported by the characteristics of the industry.

In the analysis of subtle controls, the parent country effect has to coexist with the industry characteristics. The industry is an explanation of the similarities found in subsidiaries from different countries in the same industry. When the parent country pattern supports integration between the corporate offices and the subsidiaries and this tendency is supported by the characteristics of the industry, the presence of subtle devices is facilitated. By contrast, when the parent country supports integration but there are stronger demands for localisation (e.g., a multidomestic industry), fewer subtle mechanisms to facilitate integration are in place. The success of the subsidiary, for instance in a multidomestic industry, depends on its ability to adapt to the local context. The control mechanisms implemented will concentrate on facilitating this aim.

7.4 Conclusions

The comparison of the implementation of control mechanisms in MNC subsidiaries highlights the following points. Firstly, it is important to recognise the complexity associated with the analysis of these devices. The specific combination of control devices in the Venezuelan subsidiaries is explained through a framework that integrates variables from different levels, macro and micro, which have forces that create pressures on the MNCs and are going to reinforce in the subsidiaries the presence of one type of control mechanism rather than other.

Secondly, the analysis of the cases demonstrates the dynamic nature of the BSs, and how they are exposed to change and modification (e.g., German BS). The modifications in institutions from the parent country are reflected in MNCs and their operations, as can be seen in the change of the nature of the financial controls in SAP AG. For instance, the financial internationalisation of German MNCs has driven some firms to adopt a more Anglo-Saxon approach to managing subsidiary operations. However, the effect on MNCs because of the introduction of changes in the BS, might impact some organisational features while others remain the same. This situation generates hybrid forms in MNCs in which there are organisational features that are affected by the unchanged institutions that coexist with elements generated by the changes from the others.

Thirdly, the institutions from the home country do not only mould the implementation of control devices in MNC subsidiaries. The country of operations also affects the operations of the subsidiaries and as a result the control mechanisms in the local unit. The comparison of the four MNC subsidiaries operating in Venezuela sheds some light on this subject. The effect of the country of operations affects the subsidiary in three areas. The first area is reflected in the clear demands to localise certain operations and control mechanisms at the local unit. Then, the subsidiary becomes a hybrid organisation, with organisational features that are imported from abroad but at the same time have others, which have been adapted or have been developed locally.

The second area is the type of capabilities developed in the subsidiary. An important effect of the Venezuelan environment is the need for MNC subsidiaries to develop a set of capabilities that are crucial for their success in the local context but may not have strategic value for the rest of the organisation. The uncertainty of the environment forces such concentration on the MNC subsidiaries to cope with the local dynamic that the development of products, services or practices, which can be useful and transferable for the rest of the MNC, may be limited.

The third area is the country of operations effect, which is not the same to each MNC subsidiary. The presence of control mechanisms in the subsidiaries is an example of this with the slow pace of the reductions of certain control mechanisms (e.g., the expatriate managers in the oil subsidiaries) or the absence of the same mechanism in other subsidiaries (e.g., the absence of expatriate in the business software subsidiaries). The country of operations affects the subsidiaries in different ways. The greater the attachment of the subsidiary to the institutional system of the country of operations, the greater is the effect of the system on its operations.

In sum, the investigation of the control mechanisms in MNC subsidiaries requires different level of analysis. There is an intrinsic logic, in which elements from the country of origin coexist with other factors connected to the competitive context of the firm. As the MNC behaviour is shaped by the institutional settings of its country of origin, a subsidiary's operations are also moulded by the institutional arrangements derived from the country of operations. The latter institutions facilitate or restrict the growth of the subsidiary, and this evolution is reflected in the value of its capabilities for the rest of the MNC. The subsidiary evolution and the type of capabilities deployed, as Geppert et al. (2003) have pointed out, is strongly influenced by the social embeddedness of the subsidiaries in the country of operations. In this sense, how rooted is the subsidiary in the national business system allows it to take advantage of local resources or restrict its opportunities to grow.

Chapter 8: Conclusions

8.1 Introduction

This final chapter discusses the major findings of this research, in order to assess how the investigation has contributed to the understanding of the implementation of control mechanisms in MNC subsidiaries. A further section discusses the limitations of the research and makes suggestions for future research in the area.

The findings of the research support the analytical framework presented in Chapter 1. This framework was built on the integration of different levels of analysis: national (country of origin and country of operations), industry and organisational levels. The variables that make up the framework explain the presence of control mechanisms in the MNC subsidiaries, identifying effect of the country of origin in the implementation of control mechanisms in MNC subsidiaries. In spite of the increasing globalisation of firms, the influence of parent-institutions remains an explanatory variable of the behaviour of MNCs. This research has shown how they affect the implementation of control mechanisms in MNCs. In the same order of ideas, the institutions from the country of operations explain the configuration of these devices in the subsidiaries. Institutions from the country of operations matter as shapers of the devices that are implemented to control the subsidiaries' operations.

The industry, another level of analysis of the framework, is the factor which explains the similarities found in the control mechanisms from MNCs from different origins but operating in the same industry. Characteristics of the industry such as the attributes of the product or service, the industry life cycle and forces of competition are isomorphic pressures, which explain the presence of some control devices found in MNC subsidiaries. The industry mediates the influence of factors at the national level that pull for divergence. The industry level is space for reconciliation of differences among MNCs derived from their distinctive origins. It creates a room in which firms may show similar behaviour in some areas of operations.

At the organisation level, variables such as the MNC international operations and the subsidiary development are responsible for the absence or presence of other control mechanisms. A process of organisational learning emerges with the growth of the firm. This learning is reflected in the capabilities that firms develop over time and may be come a source of distinctive advantages. The implementation of some control devices aims is to support and develop these competitive advantages in the subsidiary. Finally, the subsidiary's own development is the last feature of the analytical framework affecting the implementation of different types of control. This development is shaped by the environment, changes inside the firm, and the strategy of the subsidiary to cope with these transformations. The path of this development may modify the behaviour of the subsidiary and consequently the control devices in the local unit.

This research has contributed, particularly, with new insights into the effect of the country of operations and country of origin on management control mechanisms. The analysis of the effect of the country of operations showed the influence of this factor in two main areas. On one hand, the research has shed some light on how unstable institutional systems affect the operations of the MNC subsidiaries and the implementation of control devices at the subsidiary level. On the other hand, the effect of the country of operations was also observed in the capabilities developed in the subsidiaries. These capabilities are interrelated with the development and evolution of these units. A relationship between the subsidiary development and the effect of the country of operations was identified.

The analysis of the effect of the country of origin on the control devices in the subsidiaries has highlighted two interesting points. First, it shows that institutional systems have a more dynamic nature than this research initially assumed. Second, the effect of the country of origin can be observed in the choices made by the MNC subsidiaries to deal with the local context. In order to operate locally, the MNC subsidiaries have to make choices and take decisions; however, these decisions are influenced by the origins of the firms. In the next sections, the contributions of the research to the effects of the country of origin and country of operations will be discussed in greater detail.

8.2 The Effect of the Country of Operations

This section presents the findings of the thesis that shed more light on the effect of the country of operations on MNC subsidiaries. The research observed this effect in two areas.

First, the influence of the country of operations studied in this thesis highlights the effect that an institutional context such as Venezuela's has on the operations of MNC subsidiaries. Institutional contexts similar to Venezuela are common in Africa, Asia and Latin America; however, little research or theorisation on the influence of this type of context on the operations of MNCs, has been carried out. As was highlighted in Chapter 3, there has been some empirical research on the effect of strong institutional regulatory systems on the operations of the MNC subsidiaries. It has been found that this type of institutional systems put pressures on the local units to adopt local practices (Muller-Carmen et al., 2001; Whitley 2005). On the other hand, it was also stressed in Chapter 3 that environments with less coordination among institutions, such as in Venezuela, are more prompting to allow subsidiaries to import practices from abroad. Following these points, the research looked for control mechanisms in MNC subsidiaries, which were influenced by parent country, organisational, or globalisation effects.

It was found that a host country institutional context such as Venezuela allows the adoption of control mechanisms, which are not local in origins but creates strong demands to localise them. The MNC subsidiaries have become hybrid organisations in which there is a combination of imported control mechanisms with local adaptation. Therefore, it can be expected by MNCs that set up operations in environments with weak institutions and little coordination among them that they will face strong demands to localise their control devices. The lack of strong institutions and the weak regulatory environment of formal contracting in the country make difficult the adoption of organisational practices without partial or full localisation. When the practices require institutions with different characteristics to support their introduction, their adoption will be difficult (e.g., the adoption of stock plans in oil subsidiaries). In this case, the organisational practices need to be adapted to what the institutions of the country can allow and support.

The instability of the institutional system acts as a strong force which pulls towards localisation of the activities and practices of the local units, which is reflected in the adaptation of the control mechanisms deployed by the MNC subsidiaries. However, it is important to mention that the nature of the local demands that bring pressures for localisation is not the same for each subsidiary. For instance, there are clear differences in the presence of expatriates in the oil MNC subsidiaries compared to the business software subsidiaries. This difference is largely explained by the interaction that the subsidiaries from the two sectors have with the institutions of the country, particularly the state. Therefore, it can be hypothesized that the greater the interaction of the subsidiary with the institutions of the country of operations, the larger will be the influence of these institutions on the operations of the subsidiary, making more difficult the adoption of organisational practices from abroad.

Second, the case studies highlight the effect of the country of operations on the development of capabilities in the MNC subsidiaries. As discussed in Chapter 3, the country of operations can be an important shaper of subsidiary capabilities. The chances of a subsidiary to develop capabilities, which might have a strategic value for the MNC, are framed by the opportunities and constraints that the country of operations offers to the local organisation. This development of capabilities is associated with the evolution of the subsidiary and the decisions taken by the corporate offices to invest or divest in the local unit according to the performance of the subsidiary. The oil MNC subsidiaries are an example of this effect. A set of expectations was created when the subsidiaries were set up in the country. As discussed in Chapter 5, those initial expectations were associated with the potential growth of the subsidiaries, which implied further investments in the local units and an increase in their value for the MNCs. However, the institutions belonging to the country of operations, as discussed in Chapter 7, were a major shaper of the development of capabilities and, consequently, in the decision of the corporate offices to divest in the oil subsidiaries. The development of these subsidiaries, in which *PDVSA* and the Venezuelan state played an important role, did not fulfil initial expectations; local institutions brought on a decline in their value.

Institutions from the country of operations matter as an important factor to explain the evolution of subsidiaries. MNC subsidiaries are organisational units that are embedded in a specific context, one that consists of both institutions and markets. The combination of these two features has to be incorporated into the analysis of the MNC subsidiaries, particularly to understand their development and evolution. This research sheds some light on this subject, which is generally neglected, in the subsidiary development research stream of thought, as presented in Chapter 1. The stream has concentrated its analysis on the effect of the market structure on the operations of the subsidiary, with little attention given to the effect of institutions belonging to the country of operations on the subsidiary evolution.

This research has contributed to better understand the effect of unstable institutional systems on the operations of MNC subsidiaries. Nevertheless, further research in the area is needed because of the increasing investment of MNCs in countries with similar institutional systems. There is need for research from both a theoretical and empirical perspective.

8.3 The Effect of the Country of Origin

The country of origin, according to this research, is one of the major shapers of the behaviour of MNC subsidiaries. Its effect is seen in the development of the four case studies, as was presented in previous chapters, and cascades down to some of the control devices implemented in the subsidiaries.

The initial approach of this research to the effect of the country of origin on MNC subsidiaries had a static view of the institutional system. In Chapter 3, different institutional models were selected to explain the characteristics of the business systems of Britain and Germany. One of the key assumptions of this model was the strong nature of the institutions, and the difficulties associated with the introduction of change. The case of Germany is particularly illustrative. The nature of the institutions of the country and the alignment among them, it was argued, make difficult any change in the system. Thus, a static nature of the system was assumed, in which the firms were locked into each other's actions, encouraging cooperation among them by limiting exit opportunities. The analysis of the implementation of control mechanisms in the MNC subsidiaries was initiated with this approach to the country of origin effect, expecting a particular and specific type of control mechanism according to the country of origin of the firms. However, the existence of control devices that were not those expected according to the nature of institutions of the country of origin, led to identifying changes in those institutions. It was found that some country of origin institutions were undergoing a process of change, such as the case of the financial system in Germany.

From a theoretical perspective, this research validates novel propositions in the institutionalist stream of research that stress the more dynamic nature of institutions (see Morgan, 2005). This stream of research of the institutionalist theory takes a more innovative approach, with a position that considers that firms have the possibility to explore options which may not be supported by national institutions. Moreover, it looks at institutions as entities which are subject to change and realignment, studying how this process affects organisations embedded in the system.

Morgan (2005:450) in his defence of a more dynamic approach to studying institutions has stated: "this will happen as our studies become more intensively historical, more sensitive to diversity within institutional settings, more cognizant of the inter-relationship between national and international contexts and finally more willing to recognize uncertainty, ambiguity and experimentation at the level of firms and institutions". The cases of the German subsidiaries illustrate how changes in the home country institutions have an effect on the control mechanisms in the subsidiary, particularly on the financial controls. The nature of this control in the two German subsidiaries shows that firms are increasingly concerned about their financial performance and are developing forms to monitor profitability in more accurate ways. The financial internationalisation of SAP, with an important participation of Anglo-Saxon shareholders, is the main driver of the careful monitoring of the firm and generation of revenues in the subsidiary. This case highlights the fact that firms can take actions to become detached from their home institutions and to search for opportunities that the home institutional system does not provide. SAP, in order to support its international expansion, looked for alternatives of funding in international markets rather than local ones.

By contrast, the financial internationalisation of Preussag has been limited; however, the firm is becoming more profit-oriented and initiated an implementation of tighter financial controls in the Venezuelan subsidiary. As Vitols (2003) has stated, there is a liberalisation of the financial regime in Germany, led by the country's banks. A sector of the financial industry looks to serve the needs of large corporations such as Preussag, adopting a more US-style of investment banking which is more concerned with returns in the short-term. The case of Preussag supports the proposition that there is the possibility of change in institutions, and raises the question of how this change permeates organisations and affects their practices. The research has analysed, on one hand, how the process of change in institutions has affected the implementation of financial devices in Preussag. And on the other, it has shown how firms are not locked into a particular system and have possibilities to take actions that may not be supported by the institutions of the country of origin.

The cases of the British MNC subsidiaries also show traces of the effect of home-country institutions, too. The evolution of the MNCs and the strategic decisions that they have taken in order to grow are explained by factors related to the local context. For instance, there is the case of Lasmo a firm that initiated operations as a venture capital company and took radical steps to become a MNC. The investment decisions of the MNC were facilitated by the less regulated British environment, compared to the German one, that has fewer restrictions for British firms to move capital and resources abroad. The British ownership of firms, which looks for profits in the short-term, also explains the risky investment that Lasmo made in Venezuela, offering the largest bid among the investors. This may also explain the Invensys acquisition of Baan, which was a firm with financial problems at the time of its acquisition. The decisions taken by the British, Lasmo and Invensys, firms with a grater risk-taking mentality, in which the generation of profits in the short-term represents an important aim, explain their decisions over investments in Venezuela.

The research findings support the claims concerning the effect of home-country institutions on the operations of MNCs, and the country of operations institutions in the case of the subsidiary. However, it has also been found that institutions have to be seen from a more dynamic perspective. In both home and host country, the respective institutions are exposed to change and realignment; this process influences firms within the system and drives them to take decisions to adjust to changes in institutions. This adjustment may have two levels: when it occurs in the parent country, the adjustment may affect the whole operations of the MNC; and when it occurs in the institutions of the country of operations, it affects only the operations of the subsidiary.

Another important effect of the country of origin is reflected in the selection of organisational practices when the MNC subsidiaries are set up in a new country. The MNCs come to the country with a plan of how to control their operations; however, the interaction with the local context determines which of these forms of control are more effective. As the cases of this research have shown, the subsidiaries have to adapt to local pressures, and the country of origin of the MNC shapes the selection of the options to cope with the local environment. For instance, the differences found in managing the relationship with *PDVSA* in the case of the German and the British oil subsidiaries, clearly highlights this point. The different roots of the two MNCs explain the different approaches of the two oil subsidiaries. In the case of the German oil MNC, the strong use of personal networks to monitor operations in Germany facilitates the adoption of similar mechanism to relate to *PDVSA*. By contrast, British firms rely more on impersonal mechanisms to control their operations, which make it more difficult for the British subsidiary to find alternative devices to manage this relationship. Firms that belong to different contexts and face the same circumstances might react in a different way: their response is shaped by their origins and by the capabilities that they have developed over time.

Institutions from both the country of origin and country of operations are important forces, which shape the presence of control mechanisms in MNC subsidiaries. Their effect permeates to the levels of the local units in MNCs, as this research has shown. Nevertheless, it is important to look at them from a more dynamic approach. This approach has the underlying assumption that they can change over time, and in that process they will affect the organisational practices adopted by firms, as was the case of the MNC subsidiaries in this research.

8.4 The Presence of Control Mechanisms in the MNC Subsidiaries

The research has shown the complexity associated with the study of control mechanisms in MNC subsidiaries. This complexity is due to two major reasons. First, the explanation of their presence does not correspond to a single factor: there is a combination of them as the explanatory reasons for the presence of these devices. Second, the nature of these factors is dynamic and their characteristics may change over time: as was explained above in the case of institutions, there are possibilities of modification of the nature of the control mechanisms. Any change in the forces that intervene in their implementation might change the characteristics of the mechanism, altering the nature of these devices in the MNC subsidiary and their combination.

For instance, the pressures to substitute expatriate managers by local personnel in the oil subsidiaries may continue; therefore, the MNCs have to find other mechanisms to manage their operations in Venezuela, and possibly the combination of these devices in the subsidiary will change. The study of control mechanisms requires a framework built on multiple level of analysis in order to explain the presence of these mechanisms. As the subsidiaries operate in multiple spaces that are interrelated, i.e., the local context, the industry that the MNC belongs to, and the background of the firm, they all exert some kind of influence on the operation of the local unit. Therefore, the study of these organisations in general and the control mechanisms in particular should include multiple factors; otherwise the analysis will be incomplete and present partial explanations of the reality that MNC subsidiaries cope with.

8.5 Limitations of the Research and Suggestions for Further Research

The control mechanisms may change over time, as the research has demonstrated. An area that requires further study in the implementation of control mechanisms in MNC subsidiaries is the micro-political process within the organisation that can influence the implementation of these devices. Subsidiaries are entities struggling to develop their own identity: in this process the local managers may take advantage of their local resources, such as their knowledge of the local context, and may reject mandates from corporate offices on activities and controls which can affect their level of autonomy or their own interests (Ferner, 2000).

The increasing pressures to substitute expatriate managers with local personnel in the oil subsidiaries are an example of this micro-political process. In the event that the expatriate managers in the subsidiary perceive a threat to their own interests in this activity, they may oppose their substitution by local people. Something of a power struggle between locals and expatriates may occur at the subsidiary level, as expatriates seek to preserve their positions even as locals attempts to take over expatriate position. These strains, in turn, influence the implementation of practices and control mechanisms in the subsidiary.

In addition, there are groups at corporate level who are struggling for power and try to impose their own preferences. In this process, the control mechanisms deployed at subsidiary level may partially reflect the inclinations of a coalition.

For example, between expatriates at the subsidiary and their allies at headquarters. A deeper analysis in further studies of the influence of micro-politics in the implementation of control devices will shed more light on the importance of this effect as a mediator of the effects of the country of origin, country of operations and industry. Micro-politics may be more important in longitudinal studies of the implementation of control mechanisms. As we have stated above, the control mechanisms can change overtime, in this process of change aspects such as micro-politics can play an important role in the substitution of one mechanism by another. Coalitions and groups of interest may exert their power to support or reject the implementation of a new mechanism as this research has shown in the case of the expatriate managers.

This research has highlighted the value of case studies in carrying out comparative research. The cases as an empirical investigation, as presented in Chapter 2, are a useful method when there is no a clear separation between the phenomenon and the context, as was the case with this research. In addition, the value of a qualitative methodology in comparative research has been confirmed. The use of this methodology has facilitated the identification of the causal mechanisms that underline the implementation of control mechanisms in MNC subsidiaries. It has also allowed understanding of why and how these causal relationships affect the implementation of these devices.

Ideally, the case study method also offers the possibility to design a case sample that matches the research question and increases the external validity of the research. However, in practice there is a limitation to this method because of the real possibilities to find cases that satisfy all the conditions of the sample design. This is more obvious when the research is carried out in countries with limited foreign investment, and there are a number of conditions that have to be fulfilled in order to carry out the comparison, as was the case of this research.

Another aspect to consider in the use of the case study as a research tool in the study of MNCs is the increasing difficulty of finding "pure cases". This point is also relevant in the study of industry of operations. Moreover, mergers and acquisitions across borders are increasingly common in international business. Therefore, it is difficult to establish the identity of the firm and the influence of the parent country. When a research project is carried out over a period of a couple of years, organisational changes may occur during the period of the research. There are some methodological implications of this feature. On the one hand, the researcher should be aware that the selection of cases may include cases which are not pure and this should be justified methodologically. On the other hand, the research design of a project, which has a multilevel analysis should consider the possibility of change. Among those changes are those pertaining to ownership of the firm (at national level), entry in new markets following the development of new products (industry level) and changes in the evolutionary process of the firm or the subsidiary (intra-organisational level). Doctoral researchers who are working on the study of MNCs should consider this variable into the research framework when they carry out research of this kind.

This final chapter has summarised the main conclusions of the thesis. It has highlighted the main contributions of the research which are concentrated on the effect of the country of origin and the influence of the country of operations on the implementation of control devices in MNC subsidiaries. Finally, the chapter has discussed the main limitations of the research project and has made suggestions for further research in the area.

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